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3 JULY 1989



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# ***JPRS Report***

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## **China**

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# China

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**Thoughts on Ideology, Politics**  
*HK0206061989 Beijing GONGREN RIBAO*  
*in Chinese 11 May 89 p 3*

[Article by Liu Ji 0491 0679 of the University of Science and Technology for National Defense: "Thoughts on Ideological and Political Work During the New Period"]

**[Text] I. Ideological, Political Work Faces Grim Challenge**

For a Marxist, a challenge is precisely a chance for development. The vitality of ideological and political work rests in facing the reality and fearlessness of challenge. At present, every country in the world is searching for the path to reform and our country has also entered the critical time of overall and profound reform. The changing of the old system and concepts into new ones will lead to changes in people's way of thinking, concept of value, and style of action; it will cause adjustment of the relations of interest, provoke mental conflict, and necessitate urgent ideological and political work to immediately and scientifically solve the conflict to secure a smooth process of reform. However, the present ideological and political work has met with opposition. The reasons are: First, some people have not completely eradicated "leftist" aspects from their minds. They are still immersed in an idealized fog and therefore often hit the wall. Second, some people think that the situation has changed and ideological and political work is something which may or may not be necessary, or may even be abolished. Third, more people are puzzled by how to grasp ideological and political work in the new situation. Amidst these there is the continuation of sentiment, unclear recognition, reversal of theory, stagnation of practice, subjective assumption, and crystallization of thought. Ideological and political work has been the "strong point of our party" but at present we are in confusion and the negative result of that confusion is trouble. How should we run our ideological and political work?

**II. Strengthen the Concept of Respect**

We should establish the manner of respecting, understanding, considering, and encouraging others as a basic guiding principle which must be followed in ideological and political work. This is a breakthrough in the understanding of our party's ideological and political work. This work involves man, and man is the basic force for building socialist modernization. We must treat man with sincerity, convince him with reason, and touch him with passion. In order to positively develop man's potential, arouse his enthusiasm, and bring his subjective dynamic function into full play, we must resolutely abandon the various disrespectful words and actions of encroaching, intercepting, suppressing by power, disclosing secrets, settling accounts, speaking ironically, and criticizing and attacking others. These do not constitute ideological and political work but are the evil legacy of the "left" and are obstacles against ideological and

political work in the new period. Of course, respecting, caring for, and understanding people does not mean unconditional yielding to incorrect thinking and unreasonable demands. But when upholding the principle and raising the problems we must patiently make our points in a respectful, understanding, and considerate manner.

**III. Strengthen the Concept of Commodity Economy**

To summarize our country's economy as a socialist commodity economy is our party's important development of Marxism. Our country has a natural economy background of several thousand years. The small-scale producer's sense of admiration, reliance, and closure, and his egalitarian concept of the fairness characteristic of natural economy will be replaced by the sense of self determination, independence, competition, opening, and the equality characteristic of commodity economy. Therefore ideological and political work must be tested as to whether it can promote the development of socialist commodity economy and make adjustment accordingly.

**IV. Strengthen the Concept of Material Benefits**

The basic motivation for people to work arises from the pursuit of material benefits. In the past, our ideological and political work was influenced by "leftist" thought, and we advocated "omnipotent spirit." People dared not talk about material benefits or more rewards for the advanced. The doctrine of "a gentleman emphasizes justice, a mean person emphasizes benefit" seriously affected our ideological and political work. Remuneration is recognition by the state and society of a person's contribution to the country; it is also an encouragement and award. Under the conditions of socialism, the collective system of production materials determines the channel whereby people acquire material benefits. The acquisition is realized by distribution according to labor which is in line with socialist thought and morality. Egalitarianism advocates food prepared in a large pot and shared by everyone. This is destruction of the productive forces. To protect and respect an individual's proper material benefits is the prerequisite for mutual respect among human beings. Therefore the dialectical relation of "I serve everyone, and everyone serves me" is more acceptable to the people. When upholding material benefits we must at the same time uphold promotion of the spirit of generous offering among all the people.

**V. Strengthen the Concept of Talent**

The "realization of modernization and the invigoration of China" badly needs talent. The concept of talent is the core of historical materialism. When there is talent, any miracle in the human world can be created. During this age of reform, our ideological and political work should be a breakthrough in the concept of talent. Ideological and political work always involves man and the issue of how to regard man has become a critical problem. To evaluate a person we must look at his career, whether he can visualize a new situation, his achievements, the

wealth he creates, and whether or not he can contribute to the development of our country and nation. As for persons who have actually made contributions, we should be courageous in affirming, rewarding, and relying upon them.

#### VI. Strengthen the Concept of Returns

The highest comprehensive returns equals, in the same duration of time and with the same amount of input, the best attainable result. The emphasis on returns is the prerequisite for the prosperity of a country, a nation, or an enterprise. The people of Shenzhen have the following slogan: "Time is money, returns are life." We must attach importance to returns in ideological and political work and not overlook them. We must reject formalism, unrealistic titles, and superficial essays. "Be practical and realistic and begin everything from considering the reality." In ideological and political work we should not pursue the one-sided "talk 100 times and family visits 50 times." The key point is whether the problem is solved or not. If the problem can be solved once and for all then why 100 times?

#### VII. Strengthen the Concept of Competition

The development of commodity production will bring about competition. "Spray will not rise if the water surface is not touched and a man will not rise if he is not stimulated." Competition can place a man in an eager state, arouse his energy, and bring his subjective dynamic function into full play. We should therefore face the reality, openly acknowledge competition, and even launch normal competitions. The ideological and political work should foster among the people the confidence of sure victory in competition. A country should have national spirit, an enterprise should have fame, a team should have morale, and a man should have aspirations. We must encourage the people to compete for the first position in business, the first position in the country, and the first position in the world.

#### VIII. Strengthen the Concept of System

Ideological and political work should introduce the concept and method of system. A man can be seen as a system and his motive, purpose, aspirations, world view, sentiments, personality, and temperament can be seen as the factors in the system. We must study the mutual relations, functions, and influences of these factors impelling the formation of a man's perfect personality and advanced thought. A man must move about in the big system of society and his thoughts can be studied from the viewpoint of the big system. There are various factors influencing people's thoughts. For example, political and economic factors and those relating to social habits and traditional culture. The management of man should therefore begin with a multi-dimensional approach and comprehensive measures. In general, a society controls man by laws, morality, discipline, and belief, and through effective management achieves the

purpose of control over man or of man's self-control. All these need ideological and political work to perfect their relations in various respects.

#### IX. Strengthen the Concept of Construction

The saying "everything must be seen from the viewpoint of construction" is a rule recognized by our party concerning building spiritual civilization after summing up profound historical lessons. At the time when our country basically completed socialist transformation and started peaceful construction, the tune of "take class struggle as the key link" became louder: "stress politics," "condemn both in speech and in writing," "great criticisms clear the way," "place a battlefield in our mind," "wars break out deep in our soul," and "struggle furiously against the sudden thought of selfishness." These nonconstructive concepts and actions interrupted and clashed with economic construction, retarded China's historical process, and gave us a profound lesson. We stress that ideological and political work should strengthen the concept of construction. First, for people who have different views, shortcomings, and make mistakes, we must do more to persuade than to criticize them. We must be skillful in transforming negative factors into positive ones. Generally speaking, there should be more occasions of reward and less of punishment. There should always be an atmosphere of reward and not of punishment. The occasion of reward should be big and that of punishment, small. Second, ideological and political work must not be equated with ideological struggle. Third, ideological and political work should not aim only at destroying without establishing. The historical conditions are different now and our practical duties have also changed. In the present stage, ideological and political work generally seeks to establish first (that is make the reasons clear), then destroy (that is correct mistakes), or to establish and destroy at the same time.

#### X. Strengthen the Concept of Science

Ideological and political work is a science. During the formative process of its scientific system, ideological and political workers must further broaden their perspectives, further acquire overall knowledge, further enrich the levels, further cool their heads, and be more pragmatic. Through practice we will study, explore, summarize, and reveal its secrets. We will grasp its rules and strive to create a scientific system which is dynamic and reflects the mood of the day. First, we must employ an organization network. We must "simultaneously use the five channels" of economic, legal, administrative, disciplinary, and ideological measures. At the same time the masses must be mobilized to carry out ideological work and we must gradually form a multi-dimensional, criss-cross, stereoscopic, multi-directional, and complex network of ideological and political work. The network should really be able to perform the guiding function and change the previous one-sided pattern of treating the head when there is a headache or treating the leg when there is a pain in the leg. Second, the assessment must be

quantified. Marx once said that any science not using mathematics is an imperfect one. The assessment of bad or good thought and morality must be gradually quantified. We must combine qualitative with quantitative analysis to overcome the long-standing errors of the unscientific practice of relying only on qualitative assessment. Third, we must use three-dimensional measures. We must fully utilize modern educational methods such as newspapers, journals, television, and radio...so as to form a multi-scope, multi-directional, and stereotyped educational environment. Fourth, there must be standardized management. Ideological and political work must establish a mechanism which will cause people to follow certain behavioral standards for the sake of control or self-control. Fifth, information exchange must be stressed. In ideological and political work, we must attach importance to the collection, analysis, storage, and transmission of information. We must be skillful at grasping the effective information and abandoning that which is ineffective or void. We must change in order to deal with change, be quick to deal with that which happens quickly, be flexible in dealing with the flexible conditions, and seek practical results in a practical manner.

**XI. Upholding Patience in Education, Carrying Through Persuasive Policy, and Adroitly Guiding Action According to Circumstances Are Effective Measures in Solving the Ideological Problem**

The 10-year reform has proven that in major decision-making the most precious experience we learned from solving the ideological problem within the party was to uphold patient education and carry through persuasive policy. The theories of Marxism and Leninism must be inculcated because the proletarian world view will not spontaneously appear and exist. There are many educational methods and we must not just stress inculcation. We must not teach passive acceptance and neglect positive creation. Honesty, obedience, and unanimous opinion are potential danger signs. A correct theory, or thought, or concept will have a lasting function only if it becomes inherent to an individual. The persuasive policy is effective because it conforms to the rule of development of the human mind; second, it conforms to the practical standard of the great masses of our political work cadres; and third, it conforms to the characteristics and demands of ideological and political work. The persuasive policy can be summarized into 32 characters: A practical starting point, a high aspiration, an equal footing, a mutual influence and, move by passion, enlighten with reason, encourage and direct action, and persevere to the end.

**XII. Educate in Happiness, Literature, and Various Healthy, Easy, Pleasant, Artistic, and Noble Activities To Regulate Spirit, Relieve Fatigue, Increase Knowledge, and Raise Awareness**

When the ideological and political work is developed in the form of cultural activities enjoyed by the people, each participant is an educator while at the same time

receiving education. This can change the pattern of relying on a small number of political work cadres for ideological and political work.

**XIII. Leaders at Various Levels Must Hold Direct Dialogue With the People, Answer Their Queries Directly, Publicize the Party's Principles, and Explain Various Policies**

A successful and fine dialogue requires an equal footing for both parties and must be bilateral and practical. In the dialogue the truth must be told and after that the real work must be done. The leader in the dialogue should have a good sense of being a civil servant and possess good knowledge. He should be able to grasp the people's thoughts, have a strong ability to express himself, and have charisma. In the dialogue he must pay attention to the following: (1) he must not elevate himself and speak with hostility; (2) he must not be ambiguous and speak equivocally; (3) he must not accommodate himself, be conciliatory, and forever cater to others; (4) he must use words irrelevant to the topic; (5) he must not raise several problems at once and attempt to solve them immediately; and (6) he must not become angry when hearing criticism and refuse to accept it. All these require that the leader can do the following for each dialogue: Before the dialogue, serious preparations must be made; during the dialogue, problems are sincerely discussed; and after the dialogue, resolutions are realized one by one. We must open up the big way, block the small path, exchange information, and establish a network. We must perfect the system of dialogue step by step and make it a regular event.

**XIV. Properly Handle the People's Opinions, Care for Their Suffering, and Relieve Their Worries and Hardships**

One of the weaknesses of our ideological and political work is manifested by the "baby who knows how to cry gets more milk." This extremely unjust phenomenon is paradoxically considered by many people to be the "self-evident social truth" of our present society. This has encouraged some people who lack self-consciousness to "stir up trouble for the sake of benefits." The result is "a big stirring up for a big solution, a medium stirring up for a medium solution, and a small stirring up for a small solution." As a result, there comes the abnormal psychology whereby "an honest man will surely suffer losses" and the vicious circle causes damage to the authoritativeness of our ideological and political work. When handling the people's opinions and demands we must make detailed analyses, distinguish situations, and seek perfect solutions. If there are conditions for solutions to reasonable demands and proper opinions, we must not delay, but seek timely, fair, and reasonable solutions. For proper opinions and reasonable demands without conditions for immediate solution we must patiently explain the situation to the masses and, at the same time, strive to create conditions for solving them at the earliest date. For improper opinions and unreasonable demands we must not make unprincipled accommodation and, for

those who deserve explanation, we should explain; for those who need education, we should educate; and for those who require criticism, we should criticize. In any case we must prevent these opinions and demands from spreading.

**XV. Discover Models With the Characteristics of the Days From the Masses During Their Practice of Reform and Construction and Objectively Publicize Them**

The lecture given by a model using his own experience as an example is convincing and affecting. Talents are created by the situations of the age and each age has its own heroes. We have Zhang Side in the Yanan Period, the five heroes of Langya Mountain in the war against Japan, Dong Cunrui in the War of Liberation, Wang Jiguang in the War to Resist U.S. Aggression and Aid Korea, Ma Hengchang in the 1950's, and Lei Feng in the 1960's. Their achievements "illuminate the human world." We historical materialists must acknowledge their historical functions and also perceive the historical limitations of their achievements. In these days when we are carrying out the overall and profound reform we must advocate: to "realize the four modernizations and invigorate the Chinese nation," and for the ideal of communism, we must have the revolutionary spirit of leading the tendency of the days and of brave exploration and dedication, and be prepared to sacrifice our lives when necessary.

**XVI. Leading Cadres Must Set an Example**

Old and new comrades alike must pay attention to setting an example. Those comrades now retired should cherish the glorious experience of once playing an exemplary role. The leaders shoulder great responsibility for organizing and educating the masses and delivering

propaganda to them. A leader should set himself as an example and combine this with his words. The former is even more important than the latter. An educator must first receive an education. He must discipline himself but be easygoing when dealing with others and set himself as an example to affect the masses. This is the true quality of our party's ideological and political work. Why must we emphasize the exemplary role played by the leaders? Because it is an aim decided by our party. The great masses will say: The image of a leader is our mirror and his measure is our ruler. We should never forget our function as a "mirror" and "ruler."

**XVII. Grasp Professional Ethics To Educate the People—Establish and Promote Socialist Morality for the Whole Nation**

The characteristics of ideological and political work in the new period are the tailored efforts to carry out education in professional ethics, professional responsibility, and professional discipline for the workers in various trades. The education in professional ethics should be launched in conjunction with developing different styles of spiritual civilizations built together or by oneself, and should be manifested in work and duty. It should be launched in conjunction with strengthening management and absorbed into various rules and regulations. It should also be launched together with efforts to change social habits and permeate the civilized, healthy, and scientific lifestyle. It should also be launched in conjunction with improving the workers' ideological and professional qualities and transformed into a self-constraining mechanism fostering the improvement of business skills and interpersonal relations. In our society everyone must have his occupation, and if each can consciously uphold his own professional ethics, we will have a harmonious and untied society.

## NATIONAL AFFAIRS, POLICY

**Economic Situation, Theory, Policy**  
40060624 Beijing JINGJI YANJIU in Chinese  
No 3, 20 Mar 89 pp 11-20

[Article by Chen Dongqi 7115 2639 3825, member of the group for the analysis of economic situation, revised in February, 1989: "Economic Situation, Economic Theory and Economic Policy"]

[Text] Readjustment and austerity, which were started some four months ago, have made preliminary successes in some areas. Overall improvements are, however, still unremarkable and are far from our goals. Nevertheless, it seems that the current readjustment and austerity measures are slackened. Not only must we loosen the credit control because of shortage of capital<sup>1</sup> but it also brought about in the economics theoretical circle expressions of "prevention against decline," "anti-stagnation," and requests for another economic "soft landing." We should uphold the principle of "straightening out, consolidating and reforming" the preliminary successes, fundamentally change the macroeconomic guiding ideology of striving for lofty goals and instant results, and develop our reforms and development along the road of "making progress through steady paces." Not only does this lay before us a severe test, but is of great importance to whether or not a large-scale and corresponding overall reform will be started on schedule in the first half of the 1990's. We hold that one should understand the situation from a long-term perspective, uphold the set policies which integrate "making progress through steady paces" with management of supply and demand, earnestly do well in this year's readjustment work and that of the next, and create favorable conditions for making headway in our innovative reforms.

### I. Economic Situation and Our Difficulties

In 1988, we made great successes in strengthening enterprise reform, reforms in the coastal areas and their economic strength. Moreover, in our current reform, it was another year of high growth rate and overheated development after the 1984-1985 period. The major manifestations of "rapid growth" and "overheating" were that industry, particularly the processing and manufacturing industries, expanded at a scale exceeding its normal requirements, while basic industry such as agriculture and energy resources, raw materials and transportation grew at a slow rate. Such strong contrast in the growth rate of industry and products<sup>2</sup> further disturbed the equilibrium level of such industry and products. Though there was a substantial increase in nominal overall supply backed by the output value of industry, particularly processing and manufacturing industries, it was comparatively lowered because of a drop in the effective supply provided by basic industry such as agriculture and energy resources, raw materials and transportation. As the growth rate of energy resources fell behind the overall growth rate of industry, at least

one-fifth of China's factories would be forced to suspend production or operate less than full time. If we take the drop in the quality of industrial products into consideration, the effective supply and nominal overall supply of an industrial product alone show a great difference. Proceeding from this viewpoint, the gap between effective supply and effective demand of the whole society is much greater than the 224.3 billion yuan figure indicated by statistics. To put it in a nutshell, the extent of insufficient effective supply and excessively brisk demand in the economic system, dislocation of the structure, excessively strong market pressure, as well as the potential panic about grain and the panic about energy was similar to that of the 1958-1978 period, thereby forming a development pattern of "three eights."<sup>3</sup>

The measures for "straightening out, consolidating and reforming" which were adopted in the fourth quarter of 1988 aimed at cutting investment in capital construction, reducing the growth rate of industry, controlling the construction of buildings, halls, and institutes, checking the purchasing power of social groups, and straightening out the circulation order. To a certain extent, they have only checked the trend of "overheating" and further expansion. Since these measures were adopted not long ago, the economic system is not yet sensitive enough to reflect the situation, as well as wishes of and attitudes taken by some localities and departments. Hence, the results of austerity are not yet obvious and our goal of checking such rapid development is yet to be realized.

Our common sense indicates that under the competitive market economic conditions and centralized planned economic conditions, we may usually achieve our predicted results within an austerity period of 6 to 11 months. At present, due to the co-existence of both the new and old systems, as well as the strengthened decentralization of power to localities while decentralizing certain power to enterprises amid the "bi-directional decentralization" reform, the centralized authority of the central government becomes weakened, and standardized indirect readjustment, particularly the role of readjustment through banks and laws, is not strong enough, our current austerity measures may take a longer time to make achievements. We must adopt practical measures and steps to cool down the economy, and be determined to spend more time on getting rid of scourges. This requires us to be sober-minded when analyzing the situation.

**1. The growth rate of industry is still very high.** Though we started the consolidation work in the fourth quarter of 1988, the overheated economy did not subside. Proceeding from 1988 as a whole, the actual growth of industry climbed higher each quarter. Its respective growth rates in the first, second, third, and fourth quarters were as follows: 16.7 percent, 17.6 percent, 18 percent, and 18.8 percent. It is estimated that the growth rate of industry as a whole in the first quarter of this year might drop to about 10 percent, reduced by 6 to 7

percent compared to the same period last year. But such growth rate is still a high one. If we do not spend much efforts on carrying out the austerity measures, those newly implemented readjustment measures will be undermined. Moreover, the growth rate will bounce back and start soaring in the coming autumn and winter even though we have further cut the rate by 1 to 2 percent. Therefore, such growth rate will exceed our planned goal of 8 percent set in the beginning of this year.

**2. The monetary and financial situation may become more tense.** Recently, we have repeatedly stressed the importance of controlling the issuance of currency. However, the actual result is that we have issued excessive amounts of currency. The amount of currency in circulation 1988 is equal to 86 percent of the total amount of currency in circulation in the 35 year period from 1949 to 1984. Also, it was basically equivalent to the accumulated amount of currency issued between 1984 and 1986, which was already excessively issued. Furthermore, January is the month in which the amount of currency in circulation reached its peak level. At present, it is estimated that the amount of excessively issued currency totalled more than 50 billion yuan. As there were a large number of sectors in need of funds, many projects were started with only a fraction of money, there were existence of customary income expansion and the strive to expand local credit, and a large amount of currency quickly became cash in the hands of residents, a false sense of capital need in society was created, so that the tension of currency expansion became worsened.

**3. Obviously, the difference between supply and demand is growing.** The of demand exceeding supply was 42.6 percent last year. Moreover, the difference between gross values of the two was sharply increased compared to the previous 2 years.<sup>4</sup> In the immediate future, we should narrow the difference by means of increasing the effective supply (which is mainly supply of basic industrial products such as agricultural products and energy resources), and reducing the effective demand. However, our current measures are yet to be effectively implemented. On the one hand, we still have not worked out practical measures powerful enough to stimulate a steady and long-term growth of agriculture and basic industry. On the other, the overheated demand which affects the economic coordination and operation is yet to be remarkably suppressed. Though we might cut the investment in fixed assets by more than 30 billion yuan at the preliminary stage of the austerity, and weaken the purchasing power of groups that controlled the supply of some commodities, there are at least more than three major sources leading to an expansion of aggregate demand. First, it is the customary accumulation that most additional investment was absorbed by the inventory of fixed assets, and to simply reduce any increase of investment in new projects without inventory readjustment clearly cannot help find a solution for the expansion of aggregate demand. Second, it is the expanded power of groups to purchase commodities not under

their control despite reduction of their power to purchase commodities under their control. This is one of the reasons that the purchasing power of social groups increased by 20.3 percent despite constraints of controlled purchase. Third, there was an extensive inflation of hidden income on the basis of a fast growing (the growth rate of wages earned by workers of enterprises owned by the whole people, collectives and joint ventures was increased by 22.1 percent compared to the previous year) inflation of hidden income (wages, nominal bonuses and allowances). All these may intensify the contradiction between market supply and market demand. If one takes the inflation predictions of residents into consideration, the amount of cash in the hands of residents will, of course, be increased and maintained at a very high level under the conditions of negative interest rates. Of the purchase power surplus of 1988, the amount of cash in the hands of residents was as much as nearly two times (a growth rate of 185.7 percent) at the end of the year when compared to that of 1987. A 3-year savings with interest rate linked to inflation rate was started on 1 September. The interest rate of such savings was further increased by 2 to 3 percent. But this still cannot fundamentally change the preference of residents to the practice of keeping cash in hand in order to purchase for future use rather than that of savings. Therefore, the short-term market demand will remain at a high level.

**4. Prospects of future prices and market situation are not optimistic.** Because of extensive drop of grain, cotton, and oil production last year, the growth of processing industry exceeded that of basic industry by about 12 percent, whereas the circulation channel was full of currency. If one does not act cautiously, it is possible to develop extensive shortages led by agriculture and energy crises, as well as a new large-scale market panic and price rise. We should pay special attention to certain new tendencies concerning the price rise: (a) *Price rise activated by structure* Because of irrational and biased policies toward some products and industry, and imbalanced equilibrium between macroeconomic structural management and market structure, reform measures for rationalization of prices often partially meet the equilibrium as well as the dynamic equilibrium. Therefore, periodic "revitalization of price parity" developed once and again. Such revitalization caused by a non-equilibrium structure will push up the general price to a higher level. (b) *Regional competition* In order to readjust the structural prices in a selective way, the central authorities could not but be determined to raise the price of excessively low price products within a limited scope and extent. Decisions were made on what products, and to what level, should have their prices raised first in this process of price readjustment. It might, on the one hand, absorb more resources from other regions, and on the other, it might obtain more benefits of price rise at an earlier time. Therefore, regions often compete among each other to raise prices. This also quickly pushes up the general price level. (c) *Role of prediction* Now, both



enterprises and residents have the mentality that inflation will remain at a high level in the long run. They also have strong feelings about each case of prediction of price reform. Consequently, enterprises hoard commodities on the basis of their prediction, and residents quickly withdraw deposits from banks and join in the buying spree on the basis of their prediction. This also helps push up the prices. (d) *Impact of market price* The characteristics of price changes in the past was the rise of market prices triggered by quoted prices (planned prices). Now, the quoted price fluctuates in the wake of changes in the market prices due to the extensive scope of the market. The market price is forced to rise because of shortages, so that the quoted price has no other choice but rise. All these new developments indicate that it is very difficult for us to restrict the changes in price level within the planned range, and we must spend great efforts on doing this. In particular, when readjustment and austerity have not been fully realized, and there are hidden factors of instability in our economic life posing threats to the next step of reforms, the readjusted macroeconomic policies and guiding ideology cannot be restored because of changes in the tendency of theory.

## II. Choice of Theory Through Governmental Policies During the Austerity Period

We shall inevitably scale down industrial production, investment, and consumption by implementing austerity measures and checking an excessively effective demand. In particular, we need to scale down those impractical industrial growth rates, and make fluctuation of industry dwindle. It is inevitable that facing such a phenomenon, economists hold different points of view and debate on them. Recently, the economics circle took the issue of "inflation" as the "focal point" of this year's economic theoretical study. Many newspapers and journals have been zealous in publishing articles and analyses in connection with "inflation." It seems that viewpoints on "theory of inflation," together with opinions published by newspapers and journals, have become the "new thinking," and have an influence on the government's policies.

Economists first took a doubtful, and (academically) critical attitude toward the issue. In particular, it is no wonder that they used the new thinking to criticize those "conclusions" that had been proven incorrect by new practices of reforming. Moreover, it is the only way to make China's economics science thrive. We should realize that it is not unfavorable to us to predict any stagflation in China's economy because of its austerity measures, and to remind the government to carefully consider and take precautions in the implementation of the austerity measures. They should, however, on the one hand independently study problems, propose new points of view, and shoulder the responsibility of criticizing government's policies. On the other hand, the government should proceed from objective conditions, make an overall evaluation according to short-term and long-term goals, and make a decision based on such

economic theory. The government should neither indiscriminately accept a "new viewpoint," nor accept "new viewpoints" without in-depth discussions, or our policies will repeatedly fluctuate. Also, it should not frequently alter policies and principles that have been extensively discussed, though it is necessary to consider various comments and opinions on policies when making specific decisions. For example, at present, we should correctly understand the issue of "stagflation," and government policies should not be changed despite cries of "prevention against decline" and "anti-stagflation." Still less should the government give up the four-month-old austerity policies because it is afraid of them or has certain illusions about them. If it does behave in this way, it will waste all its efforts spent on the austerity measures implemented at the early stage. Besides, this would lead to "more inflation"<sup>5</sup> and would give rise to a "great recession following a sham of a prosperous situation" like the one we experienced in early 1960's.

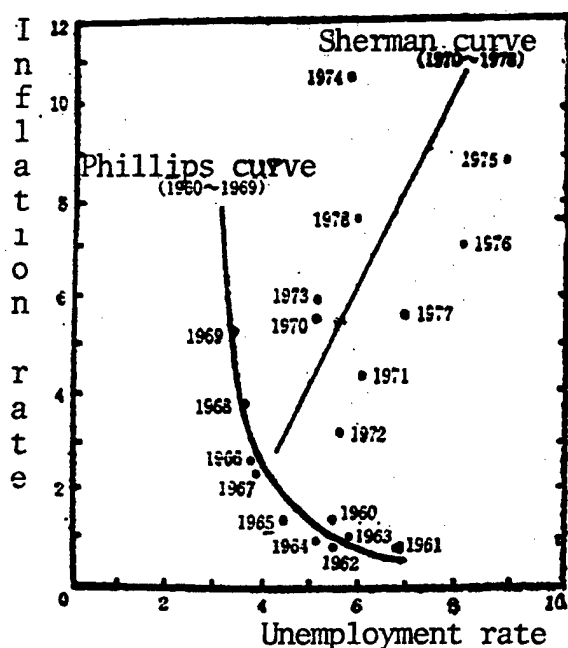
Proceeding from the economics point of view, some economists currently cherish the illusion of stagflation because they simply make a comparison between China's economy and the Western economy or the Soviet one. In addition, they have confused the concept of period or time difference with the concept of time-point, and they mix up the possibilities of short-term austerity measures with its long-term potential department.

Strictly speaking, stagflation is a phenomenon of co-existence between stagnation and inflation. It is generally manifested as a continuous process measured by a period of years (or time difference) rather than a time-point. [Please see Chart 1 for an illustration.]<sup>6</sup>

The phenomenon of re-stagflation as described by the "Sherman curve" indicated the trend of macroeconomic development in the 1970's as a whole, rather than certain particular years. Even the "Phillips Curve," which covered the economic development during the 1950's and 1960's, did not show the absence of the destructive "alternate displacement of unemployment and inflation" in particular years. Let's neglect "inflation" for the time being. "Stagnation" has been there as a tendency for several years and in the dynamic progress. Based on this interpretation, it is true that the economies of several developed capitalist countries experienced stagflation in the past 10-20 years. However, it is not true for China.<sup>7</sup> For the time being, we are not going to discuss why China experienced an "accelerated" development at the time when the economies of other large countries suffered from stagflation (which will be discussed in another article). What we do care about is the appropriate standards for determining whether the economy of China is suffering from stagflation, and what decisions should be made to handle the situation of slow growth which may occur during the austerity period.

According to an analysis of average annual growth of China's economy during the period between 1980 and 1988, we have come to the following conclusion:

Trend in Unemployment and Inflation in the United States Between 1960 and 1978



See *Stagflation* by Xie Erman [6200 1422 2581]

- I. The period in which the growth rate was over 11 percent was a state of abnormal economic growth;
- II. The period in which the growth rate was between 7 and 10 percent was a normal state of prosperous economic growth;
- III. The period in which the growth rate was between 4 and 6 percent was a state of middle-level and slow economic growth;
- IV. The period in which the growth rate was between 1 and 3 percent was basically a state of economic growth of stagflation; and
- V. The period in which the growth rate was zero percent or below was a state of economic growth of recession.

In terms of year, there are 6 out of the 39 years from 1950 to 1988 at stages IV and V, 17 at stage I, and 16 at stages II and III. If the economic growth in 1989 drops from stage I to stage II, that is, the growth rate drops to 7.5 percent, this indicates neither stagflation nor recession. Rather, it shows a normal state of prosperity. Proceeding from the tendency of certain years, for example in the past decade, we made our choice and stabilized the growth of our economy between 7 and 10 percent, that is, at stage II. Hence, we cannot hold that China's economy entered a long-term period of stagflation. This is because at the early stage of development, China's economy basically developed in the direction of abnormal growth marked by an excessive quantity expansion.

Therefore, it is normal and rational for us to cool down the economy, and cut the growth rate from stage I to stage II through macroeconomic policies. It is not stagflation, and the government policies should not be affected by any illusion of "stagflation."

Of course, if we adopt more powerful austerity measures, it is not impossible that the economic growth rate of a certain year or certain quarters will drop to stage IV or even stage V. However, such measures may be tolerated if they can achieve remarkable results in solving the dislocated aggregated quantity, realizing a structural transformation, improving the economic results and production quality, and creating a more relaxed environment for an in-depth future reform of the structure. In such extensive range of shortage, and amid the expanding demand, it is very difficult to quickly carry out reforms, opening up and development in a peaceful and joyful manner without paying any cost or suffering. Moreover, our experience in the past 40 years shows that we have to pay the costs not only because of the austerity measures themselves but also because of prevailing "overheated" situation. The austerity measures are a readjustment of such an "overheated" situation, and are our only choice. An important reason that China's economy experienced periodical fluctuations is the excessive quantity expansion backed by the thinking of rapid development. The "great recession" was brought by the "great leap forward." Now, some economists still hold that "an economy is not prosperous without a double digit growth rate." When the government cut the "double digit" growth rate down to 7.5 percent, they held that this was a "stagflation." This indicates that the thinking of rapid development still has deep roots among some of our comrades, and the thinking of the great leap forward may influence the government's behavior. Therefore, the government should make the right choice of theory when making a macroeconomic decision.

### III. Basic Point of the New Austerity Measures: Structural Equilibrium

Besides being worried about possible stagflation brought on by the austerity measures, some comrades are worried that an austerity of aggregated quantity would not help solve the dislocated structural equilibrium. In fact, in order to really solve the "structural problems," we must solve "problems concerning the aggregated quantity." These two are interrelated. It involves, of course, the basic point of policies. Proceeding from the present situation, the current austerity measures, which focus on consolidation, should be based on the basic points of structural readjustment. In other words, we use austerity of aggregate quantity to promote structural readjustment, and use the latter to realize the austerity. Specifically, we should promote a rather rapid development in agriculture, energy, and other basic industries, while reducing the growth rate of industry, particularly the processing and manufacturing industries. Of course, what we have in mind is a short-term (macroeconomic readjustment) issue, rather than a long-term (structural change) one.

In the development of China's economy, the great leap forward was actually a great leap forward for industry. The situation in recent years was more prominent. As it is difficult for the economic sector to further enhance its overall growth in the foreseeable future, and it is further restricted by internal factors if China develops the economy by making loans, an accelerated absorption of resources by industry will inevitably reduce the resources for the growth of agriculture (such as capital, agricultural means of production, trained labor, and so on). Therefore, a great leap forward for industry must be accompanied by a great recession and stagflation of agriculture. Take the 10 years of reform as an example. Between 1979 and 1984, the growth rates of both industry and agriculture were at stage II, and the difference between the growth rate of industry and that of agriculture was 2 percent. During the 1985-1988 period, however, the growth rate of industry climbed to stage I while that of agriculture dropped to stage IV, forming a sharp contrast of growth rate between the two. The difference in such contrasting development in 1988 was as much as 18 percent.<sup>8</sup> Such differences in growth were consistent with the difference in investment. Proceeding from the capital investment made by the government, the amount of investment in agriculture in the 1960's accounted for 17.7 percent of the aggregate amount of investment. The proportion gradually dropped in the 1970's. The percentage was dropped to 6.6 in 1981. In 1984, agriculture reaped bumper harvests while investment in industry was increased. Consequently, the investment in agriculture in 1985, 1986 and 1987 decreased by 2-3 percent per year compared to 1981 (the investment in agriculture in that year was very low). The link-ratios of these three years were respectively 4.5, 3, and 4.8 percent. With such levels of investment, how can agriculture avoid recession or continuous fluctuation of output? In order to find an excuse for the incorrect agricultural policies, to prove the correctness of supporting a high industrial output by making more investment in industry, and to maintain a quick pace of industrial development, some comrades use natural calamities and other non-economic factors to explain causes for the recession. This is not the right attitude. This is because no natural calamity could affect the agricultural production for four successive years! To a certain extent, it can be said that the abnormal growth (stage I) of industry in recent years was supported by an excessively low level of growth (stage IV) in agriculture. To develop industry at the expense of agriculture, and to adopt bias policies highly favorable to industry are basic mistakes of the macroeconomic policies toward the composition of industry. This is also a reflection of past chronic malady under a new situation!

In addition to the above-mentioned irrational attitude toward basic industry, there are also problems of irrationality and non-coordination of the internal composition of industry. First, proceeding from the production process of industrial products, the growth rate of production of primary products, which are mainly energy resources, mining, raw materials, and so on, is slower than that of final products, which are mainly processed finished

products. Last year, the growth rate of processing industry was 23 percent, whereas that of mining and raw materials industries was only 10.8 percent, showing a difference of 12.2 percent. This irrationality of the composition of industry is related to the composition of investment at the previous stage, which was also irrational. For example, during the period between 1984 and 1986, the difference between growth rate of fixed assets newly added by coal industry through capital construction and that of machine-building industry was widened based on calculations using that year's prices. Prices in the coal industry in 1986 increased by 1.8 percent compared to that of 1984, and prices in 1985 decreased by 20 percent compared to that in 1984. Prices in the machine-building industry in 1986 increased by 32.4 percent compared to that in 1984, and prices in 1985 increased by 27.5 percent compared to that of 1984. Thus, how could we avoid the electricity or energy crisis for the past 2 years, which was triggered by a shortage of coal and caused by such a difference in composition of investment? Second, proceeding from the composition of industrial enterprises, some of them expanded so much that they moved to the rural areas too quickly. In 1988, the growth rate of industry as a whole was 20 percent, while that of rural industry was more than 35 percent. It is certain that in order to transform China's traditional structure of rural economy, and to solve the problem of surplus manpower in the rural areas, we must take the road of industrialization in the rural areas. Under the circumstances where it is very difficult for the rural areas to start private industry, it is inevitable that they run industry in the rural areas. However, this involves the problem of development speed. If two-thirds of the rural manpower were promptly absorbed by industry, or turned to mining, brick production, machine-building, we shall be unable to achieve our goals though it seems that this may help speed up the pace of industrialization.<sup>9</sup> China learned a profound lesson in the 1950's when it mobilized all people to run iron and steel industry. As at this moment, China's rural industry is a typical industry marked by quantity expansion. Can we gradually switch, through a steady growth rate of rural industry, the development of rural industry in a direction which focuses on technological innovations?

Furthermore, China's guiding ideology had many mistakes in terms of the composition of foreign trade and domestic trade. During the period of reforms, it is more open than that during the period of traditional planned economics. It puts more stress on the role of foreign trade in the operation of the national economy as a whole. This general strategy is absolutely correct. In recent years, however, there developed the phenomenon of stressing immediate success in our specific guiding ideology on opening up. To a certain extent, the intensification of contradiction between supply and demand in the domestic market was related to the excessively expanded foreign trade. For such foreign trade, the main imports were equipment and technology for the production of future products. Therefore, the predicament in

domestic trade was mainly caused by excessively expanded exports. According to Customs, China's average growth rate of export between 1981 and 1986 was 9.5 percent per year, whereas the percentage of 1987 and 1988 was respectively as high as 27.5 and 20.8. Obviously, the relatively rapid expansion of export is one of the reasons that there was an excessively brisk demand in China's domestic trade market.

The above-mentioned analysis indicates that the excessively brisk aggregated demand in China's economy is interrelated to the bias structural policies. One cannot give an explanation about the "dislocated aggregate quantity" without the "dislocation of structure," and it is inevitable that a "dislocated aggregate quantity" will intensify the "dislocation of structure." A simple "theory on supply," "theory on structure," or "anti-inflation theory" often has the two conflicting with each other. Nobody is willing to solve problems concerning the dislocated aggregate quantity from the viewpoint of correcting the guiding ideology, or agrees on an austerity of demand. There are two basic ideological points in this respect. First, people holding this viewpoint believe that acts of control and austerity of demand "are not a permanent cure, and that we can realize system reform, particularly ownership of assets by enterprises, only through an effective control of demand. It is just as a current catchphrase says, "the only way out is to reform." In other words, it is contradictory to carry out reforms by checking demand and reforming the system by using a strengthened macroeconomic control. Second, they hold that the demand austerity contradicts speedy development, and it is not wise to slow down the development speed of industry at the expense of demand. These two points are untenable.<sup>10</sup> To negate demand austerity by emphasizing the significance of structural and supply problems is not only one-sided thinking, but also contradicts with the strategy of carrying out intensive reform and making headway in the next step.

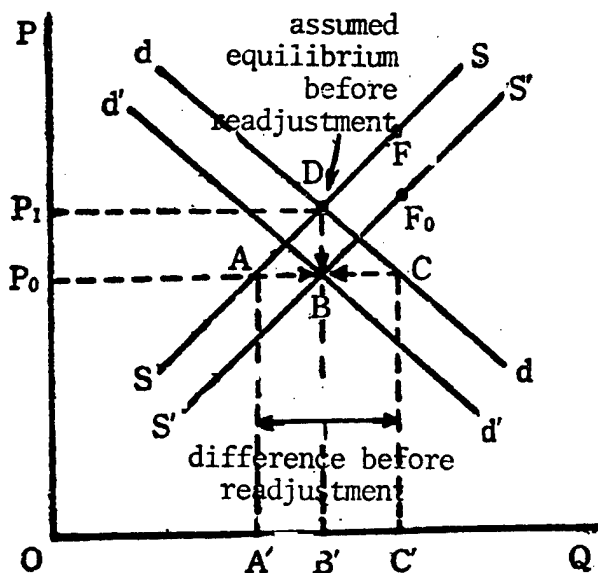
Of course, there are problems concerning the basic points of an austerity policy toward aggregate demand. After new austerity policies were started in the fourth quarter last year, we can make our way only by transforming the structure, improving our efficiency and improving the quality. However, we must understand that under the circumstances where the aggregate quantity of resources (capital, materials, technology, and so on) cannot be sharply increased in the foreseeable future, it is almost impossible to sharply increase the effective supply of basic industry such as agriculture, in particular, the production of grain and energy resources, in China's market without adopting effective measures for controlling aggregate demand, such as determined acts to check inflation, development speed of industry, investment demand by small-scale processing manufacturers; and determined acts to stabilize the quantity expansion ratio of rural industry. It therefore seems that an equilibrium of structure objectively requires us to resolutely carry out austerity measures.

#### IV. Considerations Concerning Recent Macroeconomic Readjustment

To implement austerity measures according to the set policies should make us achieve the goal of reducing the transitional demand and increasing the effective supply. This is indicated by a chart on the left. When the demand curve  $dd$  moves to  $d'd'$ , and when the supply curve  $ss$  moves to the right to  $s's'$ . Under the circumstances where other conditions remain unchanged, the price level will drop from point  $D$  to point  $B$  following a drop in demand from point  $C$  to point  $B$ ,  $OC'-OB'$ , and an increase in supply from point  $A$  to point  $B$ ,  $OB'-OA$ , thereby theoretically realizing a settled equilibrium, as well as stabilizing prices, which is the goal of our macroeconomic policies. [Please see Chart 2 for illustration.]

The above-mentioned chart is explicit in illustrating the abstract nature of the theory, though it is an assumed process of macroeconomic readjustment. However, it has proved that (1) the gap between supply and demand,  $AC$ , should neither be simply regarded as a shortage of effective supply nor be regarded as fully equivalent to a surplus of effective demand. The excessive demand is indicated by  $BC$ , while the shortage of effective supply is shown by  $AB$ ; (2) macroeconomic readjustment policies must "work along both lines": there should be an  $AB$  increase of supply, while we reduce the demand from point  $B$  to point  $C$ . It is impossible to change the supply level at point  $A$  to point  $C$ , or change the demand level from point  $C$  to point  $A$ . We can only choose a management policy integrating supply with demand; (3) the theoretical settled equilibrium point  $A$  of aggregate demand will inevitably bring about a widespread economic recession; while the demand level at point  $C$  is a rational one. For the time-being, the level of effective supply can only be chosen along the  $ss$  line, or the  $s's'$  line at most, so that the theoretical equilibrium price level will be increased to point  $F_1$  or subscript  $0$ . In the actual process of readjustment, a choice of "centripetal readjustment" taking  $B$  as the focus (see the three arrows in the chart) is feasible and practical.

For the sake of realizing the "centripetal readjustment" taking  $B$  as the focus, we should implement an urgent task of increasing the supply, which is to stimulate the production of agriculture and energy resources, as well as the output of basic industrial products such as grain, timber, animal husbandry, fishery, energy resources, and so on. All these require the government to give support by increasing the investment. In particular, agriculture cannot get rid of the predicament of recession without great support from the government. Moreover, it may enter into a lengthy period of stagnation and become a bottleneck of our forthcoming process of industrialization. The major method for stimulating the agricultural supply at present is to readjust government's macroeconomic management policies on agriculture by (1) increasing its investment in agriculture; (2) imposing



Process of Macroeconomic Readjustment: Elimination of Difference in Supply

rigid control on non-agricultural use of land; (3) imposing rigid control on hiking prices of the agricultural means of production; (4) readjusting the grain, animal husbandry, and agricultural sideline products market, appropriately readjusting prices and expanding the scale of autonomous sales in accordance with the viewpoint of peasants; (5) providing some preferential treatment concerning the supply of goods and materials, and loans needed by peasants. Of course, we may stimulate production through reform of the ownership system of land property. After taking into consideration other factors for the time being, in particular, the "chain effect of pricing system," however, we are afraid that this "system solution" is ineffective. Therefore, we should first handle well the short-term readjustment on the basis of long-term transformation.

We should carefully consider the following items when implementing the urgent task of checking demand.

### 1. Limits on Circulation of Currency and Reform of Banking

The key to checking demand is to check inflation. The present issue is how to achieve this goal. In principle, the formula of "economic growth rate plus the rate of price rises" adopted in the past 2 years was not scientific. An obvious mistake of taking the "increase compared to the previous year" as an index to determine the amount of currency to be circulated in the current year is that assuming that the amount of currency in circulation in the previous year was a rational one, such an approach ignores changes in the circulation speed of currency, changes in monetary credibility, changes in the scale of monetary capital being utilized, and other factors.

Therefore, in the new formula, we should at least consider: (a) whether the amount of currency in the previous period was excessive; (b) changes in the circulation speed of currency; (c) rational changes in the price level; (d) extent of monetarization in the economy; (e) changes in the scale of monetary capital being utilized and the scale of banks; (f) expansion and contraction of monetary credibility; and so on.

The amount of currency to be circulated should, upon being determined by basing on the new formula, be submitted to the NPC for examination and approval in certain legal forms. A person will be affixed his legal responsibility should the issue currency exceeding such amount. In order to make responsibility correspond to authority, the central banking system should be independent of the direct control of the State Council, and be directly under the National People's Congress. Moreover, the central bank should directly lead its branches. Appointment of its officials, hiring of its employees, as well as their income and welfare should be determined by the state on priority basis. All special banks are to be subject to the central bank and their respective banks at upper level, and should follow the coordination worked out by the former. At the same time, we may consider abolishing central banks at provincial level, and establishing nationwide eight to ten banks in key cities.

### 2. Readjustment of Interest Rates

As the state-owned enterprises lack a complete system of cost restrictions and profit projection. In particular, they are insensitive to the marginal effectiveness of capital.

Therefore, China's functions of interest rate readjustment are not so perfect and effective as those of the Western economic market. However, in the wake of in-depth development of reforms, the role of economic readjustment by interest rates is becoming more obvious. In particular, following the rise of private enterprises and rural enterprises, as well as collective enterprises based on their original production scale, in recent years, even urban and rural residents are concerned about interest rates. Their behavior includes acts to choose interest rates and prices that are favorable to them. Therefore, we may readjust the demand for investment and the consumption demand by making reference to readjustment of interest rates. Of course, the readjustment of interest rates should be elastic and may fluctuate in the long run. But this requires that the price level should not always go up. Therefore, the policies toward interest rates must be coordinated with other policies.

### 3. Readjustment of Taxation

Another approach to readjust the demand of enterprises and that of families is to correctly utilize categories and rates of taxes. We may consider these four points: (a) We may, during the austerity period, replace the construction tax by a tax on different types of investment, and sharply increase the tax rate. For example, we may double the tax on investment in land construction, which is now 10 percent, while we may cut the rate of taxes on other investment. However, such rates cannot be lower than the existing 10 percent. (The tax rate for foreign enterprises will be determined according to the actual situation.) (b) We may strengthen the tax restrictions, so that anyone who evades taxes will be punished according to law. We may re-assess the power of local authorities on local exemption, and narrow their difference among governments at various levels. (c) We may consolidate organizations responsible for the collection of taxes, let these organizations operate in a manner independent from the government, and establish and manage these independent organizations in the aforementioned approach. (d) We should speed up the perfection of the system of classified taxes. Under China's present circumstances, it seems that it is not suitable to adopt the policy of increasing all taxes across the board, but we may consider adopting the policy of setting different tax rates.

### 4. Restrictions on Allocation and Loans, Restrictions on Income and Consumption

A comprehensive investigation should be conducted by the State Planning Commission and relevant departments and committees on the development trend of products, industries, and enterprises, which should work out and make known a system of limitations on fund allocation and loan grants. They should cut the amount of loans, and stop providing them to products, industries and enterprises that consume large amount of energy and that have poor efficiency, and let them be merged. In the meantime, they should stop allocating funds for the construction of luxurious buildings, halls, galleries, and

institutions. They should impose restrictions on the use of public funds to purchase sedans; and for regions and departments that have been enjoying preferential treatment set by the state, they should levy taxes on that portion of revenue above the average profit amount, or rescind some of those preferential treatments, in addition to retaining 10 percent of non-budgetary revenue to the readjustment fund. In the process of limiting loans, banks should, through the examination of usage of loans, work out standardized limits for different loans; that is, loans for additional investment in fixed assets, loans for transformation of storage of fixed assets and for investment in working capital. Not only must they limit the amount of additional investment, but also the investment in storage, so that the storage of fixed assets of society as a whole is readjusted through banks, and only the best ones can survive. In the process of limiting revenue, they should also adopt measures to control the inflation of hidden revenue, which is not a part of the wage scale. On the limitation of consumption, we may consider introducing a new "scheme of domestic expenses." In addition to price readjustment (at present, we can only select some products which do not greatly affect people's livelihood). Under this new scheme, the state should, through the sale of state-owned small enterprises and public houses, absorb the money in the hands of residents while attracting their savings. In particular, the state should hold a positive attitude and encourage the formation of private capital, so that part of the short-term consumption fund becomes the revenue of the state, and part of it becomes production capital for value increase.

### 5. Readjustment of Consumer Goods Market

According to the present situation, we may appropriately readjust the organization and management of consumer goods market. For example, we may draw a lesson from the recent experience of tobacco and wine market management, abolish the method of purchasing color television sets, refrigerators, and other high-class durable consumer goods by coupons, eliminate the grey market, increase the fiscal revenue and stabilize the market by introducing another market taking an approach of integrating special outlets, open pricing with special consumer taxes. In the near future, there may be a panic buying in China's consumer goods market. The goods in question are not high-class durable consumer goods but daily necessities, which are mainly grain, cotton, oils, meat, and vegetables. We must adopt corresponding measures in this respect. Furthermore, the state should deposit at special accounts funds which are collected through the sale of state-owned small enterprises and public houses, compensatory transfer of the right to use some land, and the issuance of shares and bonds, and freeze the use of such funds for a certain period, during which it is prohibited from using such funds for reinvestment and further granting loans.

### 6. Reduction of Expenditure

During the austerity period, the government must be determined to examine the structure of organizations

and check their expenses, so that their level of expenditure will be at or about the minimum level required for the development of the national economy. In recent years, organizations directly under the central government and the State Council, as well as local government organizations at various levels, took advantage of the policies toward reforms and opening up in varying degrees. They overstaffed their organizations, and their expansion of expenditure (including the purchase of vehicles for personal use with public funds) have become an important factor causing the inflation of demand. In our next step of reform, it is necessary to spend great efforts on straightening out the government organizations at various levels, and integrate the "optimized combination" of government staff with the "optimized combination" of enterprise workers. One of the reasons that "Aihade [5337 0761 1795] Reform" succeeded between 1948 and 1949 is that the number of government staff and the amount of expenditure were greatly reduced. At that time, the number of staff working in the Ministry of Economics alone was cut by 34.9 percent. If China really carries out reform of its administration and streamlines the structure, it will cut its staff size by about one-third. This will not only ease the financial difficulties but also improve the efficiency of the government, thereby playing an exemplary role for improving the productivity of enterprises.

By using structural readjustment, we may speed up the development of such "bottleneck industries" as agriculture, energy resources, transportation, and so on, and improve the level of participation in market transactions by effective supply; and by using aggregate demand control, we may check any rapid increase in the long run, and ease the excessively brisk demand which may bring shocks to the market. In other words, the practice of increasing supply, checking demand, balancing aggregate quantity, and optimizing the structure should be the current fundamental guiding ideology concerning macroeconomic management, as well as the goal of our basic policy of readjustment and austerity in this and next years. Facts have clearly shown that any policy and advocacy which neglects "supply management" to check demand, any theory and viewpoint which treats "high speed as the only way to attain prosperity," and an economy in a period of reform, in particular, a period of reforming and readjustment, is not suitable for China.

It is necessary to stress that during the period of readjustment and austerity, reforms do not mean inactivity or cease functioning, still less restoration of the old order. If we make the correct choice and effectively integrate the policy of supply-demand management with structural reforms, not only shall we consolidate and assimilate the realized achievements, but also carry out reforms in an in-depth and selective manner. We can at least set forth the following points: (1) When we adopt policies concerning the stimulation of supply of agricultural products, we may smoothly carry out reform of land ownership, and the market of agricultural products, particularly the grain market, may gradually expand.

This will thus appropriately expand the free market while forming futures markets being operated under the rules of fair and mutual benefit transactions, which is under guidance of the state or directly participated in by the state. (2) When strengthening the control of currency, we may intensify reform of the financial system, speed up the pace of separating banks from administrative organs, so that banks will gradually gain the status of "readjustment centers" in a market economy. (3) When implementing the austerity of investment demand, we should increase the importance of readjustment by interest rates, while reducing the scope of quota control, and really accelerate the growth of the commodity economy. (4) When checking the mobile demand for consumer goods by residents, we may restrict the distribution of their income, ease the panic situation in the mobile consumer goods market, really reform the housing welfare system if we are selling public houses, and speed up the scheme of private housing according to the principle of exchange at equal value. (5) We may encourage individual persons to purchase state-owned small enterprises (in the form of sole proprietorships or joint ventures), which may thus reduce the consumption funds, check high-level consumption, speed up the pace of capital accumulation by individual persons, and expand their scale of capital. Therefore, we can see that this adjustment is different from any previous one. It is not carried out for the sake of readjustment. Rather, it is carried out for the sake of reforms and long-term development. A readjustment helps promote our reforms and provides us a turning point to carry out reforms in an in-depth manner, rather than hindering them.

#### Footnotes

1. The shortage of enterprise funds was developed not because of the adoption of austerity measures last year. Rather, it was caused by a buying spree and inflation prediction among residents between July and August last year. Because of the prediction, both residents and enterprises quickly withdrew their deposits to meet their current consumption needs and to keep materials as reserves in order to avoid depreciation. Therefore, a large sum of bank savings deposits was turned into cash on hand for residents, thereby intensifying the shortage of bank loans. Another reason for developing this situation was the "external circulation" of funds by banks, which was also developed not because of the adoption of austerity measures. Therefore, one should not put the blame of capital shortage on austerity measures.

2. Compared to 1984, the growth rate of gross industrial output value (including industry run by villages and institutions at lower levels) in 1988 was increased by 3.7 percent. That of gross agricultural output value was reduced by 10.3 percent. In 1987, the ratio of growth between industry and agriculture was 3:1. It was sharply expanded to over 7:1. The growth of gross output of grain changed from a 5.2 percent rate in 1984 to a 2.3 percent negative rate in 1988.



3. This refers to 3 years of rapid development; that is, 1958, 1978, and 1988. Though the case of 1988 differs from the "great leap forward" and "foreign leap forward," they shared, in terms of macroeconomic guiding ideology, the same tendency of striving for quick results and a rapid pace of reforms and development.

4. According to reports of the State Statistics Bureau, 41.5 percent of a list of 506 industrial products compiled by the relevant departments in 1988 were in short supply; whereas 39 percent of the 141 agricultural and sideline products were in short supply. If inflation continues and prices rise further, predictions made by both enterprises and families will eventually be strengthened, the market demand (including various kinds of demand derived therefrom) will be expanded, and the difference between supply and demand will grow further.

5. A point worth mentioning is that the local governments, enterprises and residents often use tricky "countermeasures for readjustment" or "reflection in opposite direction" to undermine the macroeconomic control of the central government. Whenever the central government cuts investment in fixed assets, they would ask for more projects, investment, and construction, and would

strive for completion of all work prior to a real termination of all work. Whenever the central government imposes restrictions on loans, they would strive to find more sources to get more credit. Whenever the central government checks consumption and encourages the masses to save money, they quickly withdraw money from their bank accounts and strive to buy before inflation articles which would only be needed in the future. Under these circumstances, if the austerity period is too short, not only will the measures fail to stabilize the economy but also bring about more inflation. Therefore, the austerity period cannot be too short and the austerity measures must be right to the point.

6. This may be shown by a description of the 1970-1978 U.S. economy written by U.S. economist Howard J. Sherman. Professor Song Zehang [1345 0463 5887], a Chinese economist, also pointed out, "The so-called stagnation mainly refers to a marked drop in economic growth rate and an intensified situation of unemployment and inflation (that is, the sharp rise of prices), which have co-existed for a long time. Stagflation is a phenomenon that lasts for a rather long time." ("Economic Stagflation of Developed Capitalist Countries and Its Prospects in the 1980's" written by Song Zehang, published in "WORLD ECONOMIC INFORMATION" in issue No 1, 1983, pp 1, 4.

**Economic Growth of China and Several Developed Countries During 1969 and 1985**

7.	U.S.	Britain	France	West Germany	Japan	China
1969-1970	3.9	1.8	5.7	4.7	11.2	5.4
1970-1980	3.1	1.8	3.6	2.8	4.9	9.3
1980-1985	2.4	1.7	1.1	1.3	4	11.3

Figures in the table indicate average growth rate per year. Source of information: "CHINA STATISTICAL YEARBOOK—1987" pp 38, 862, 863; "The World's Economic Information" 1983 Vol 1, p 1; "Collection of Translated Works on the World's Economy" by Zuotengjingmingwen [1563 5671 4842 2494 2429] 1984 No 11. Figures of the United States, West Germany and Japan shown on the first and second rows are GNP values, and those on the third row are GDP values. Figures of Britain and France are GDP values, and those of China are gross output value of society.

8. In 1988, the growth rate of agricultural output value was about 2 percent, including the 20 percent of output value made by industry run by villages and institutions at lower levels. If we compare this to the output value of grain industry and industry, the difference was more than 22 percent. This is because the grain output dropped by 2.3 percent compared to 1987. Generally speaking, classification by "industrial growth stages" often moves up across the board the growth rates by 2-3 percent when compared to the above-mentioned classification by "economic growth stages."

9. The capitalist industrialization of the West took 200-300 years to complete. It is not necessary for us to repeat what they did in their cause of industrialization. We should shorten the course from an agricultural society to a modern industrialized one. However, it is also unrealistic to attempt to complete this task within several years. This would produce an "industrialized utopia" which would bring about powerful adverse effects.

10. Strictly speaking, structural reform is a relatively length process that brings no immediate effects on the equilibrium of aggregate quantity and structural readjustment. If reform of the ownership of property by enterprises will last for another 10 years before it is fully completed, it is very difficult to expect that it can solve the current problems about imbalanced supply and demand, and the imbalanced structure. A short-term readjustment cannot replace the long-term one, its reverse is also true. If no measures are taken to deal with problems, the situation will be very grave so that we shall neither achieve our goals nor recover the investment. It seems that a feasible approach is to integrate "long-term solutions" with those "short-term ones," and to integrate



stop-gap measures with preventive ones. Besides, there will still be short-term readjustment and austerity even if we have solved long-standing problems concerning the ownership of property by enterprises. Actual control and intervention by the state are still necessary even if our state-owned enterprises become their counterpart in Western countries, which are restricted by a rigid budget.

### **Industrial Production Policy Viewed**

40060546 Beijing JINGJI LILUN YU JINGJI GUANLI  
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[Article by Liu He 0491 7729, economist, Office for Industrial Restructuring, Department of Industrial Policy, State Planning Commission; Yang Huanchang 2799 3562 2490, professor, College of Chemical Engineering Management; and Liang Junping 2733 0971 1627, lecturer, Institute of Economics, Beijing University: "General Thoughts on Implementation of China's Industrial Policy"]

[Text] In the authors' opinion, China's industrial policy during the next 8 years, viewed in its actual implementation, has three basic objectives: It will be slanted toward replenishing social capital in order to provide an excellent external environment for direct economic activities and for the entry of foreign capital; it will want to strengthen the organizational aspect of the market and transform stock capital, targeted on certain key points; and it will want to give fullest support to industries that earn foreign exchange and that will provide preconditions for achieving the first two objectives.

Owing to the historical and cultural background of China's economic development, we have on a previous occasion dealt with the perception and formulation of industrial policy under the aspect of an integration of development and reform.<sup>1</sup> Now we shall make it the fulcrum to link macroeconomics to microeconomics, to blend the interests of the central authorities with those of the local authorities, and to link plan to market, and we here put forward some general ideas on industrial policy as a state-building factor.

### **I. The Two Restraints That Prevent China's Industrial Structure From Achieving a Higher Level of Perfection**

In the course of the past 10 years of reform, economic growth guided by demand has already taken initial shape in China. Under the imbalance of total volume relations, there are two forces of mainstream demand that keep increasing, and the more they increase the more they prove to be the main causes of contradictions in the industrial structure.

One is the trend toward urbanization and detachment from agriculture. Industrialization first manifests itself in the degree of urbanization and detachment from agriculture, and the latter has its cause in the profit motive of the producers. In the last few years, following

the rise in average income of the rural population and the emergence of new employment opportunities, urbanization and detachment from agriculture in China has distinctly accelerated. Employment of nonagricultural workers has risen at the rate of 10 percent per year, much in excess of Arthur Lewis's 3.2-percent warning line for the speed of urbanization, and also much higher than Colin Clark's 4.5-percent maximum experienced speed index of detachment from agriculture. Accelerated urbanization signifies expanded demand for basic industries, characterized by capital concentration, and also demand for the formation of social capital.

Faced with the overall situation of huge, dispersed growth of medium-size and small cities, which have grown under the pressure of social demand and are obviously lacking a collective interest, and due to insufficient domestic savings in addition to an extremely unsound mechanism for replenishing social capital, there are huge deficiencies in China's basic industries. Traffic is clogged, communications are impeded, electric power and raw materials are in short supply, water supplies are insufficient, and facilities of the city governments are outdated. All these problems are obstacles that throttle economic development.

As a logical consequence of insufficient domestic savings, and of the large deficiencies in basic supply, the state has resorted to raising foreign loans. The amount of foreign loans has always been a function figure in the speed of urbanization. By 1987, the amount of China's foreign indebtedness had reached \$30.2 billion.

The deficiencies in basic industries not only show up in quantitative shortages, but also in qualitative insufficiencies. Although there is an extremely large potential in China's machinery and equipment manufacturing industries, it is due to the long period of seclusion that the industry is unable to produce functionally satisfactory products that are needed, especially where large comprehensive plants are concerned. In the turbulence of raising loans and importing, these industries will soon dissipate all their energy.

We must soberly realize that the powerful trends of detachment from agriculture and urbanization cannot be reversed. What we can do is not divert this major movement, but rather work on restricting the speed of these changes in trend to a reasonable scope and providing a reasonable mechanism for expansions and contractions in the scope.

Another major trend on the demand side is the unprecedented rise in high-grade consumption. The radical change in the income distribution policy and the intersection, though partially distorted, of a market mechanism, the delegation of authority, though not perfectly carried out, changes in the policy of foreign exchange distribution, and the seductive examples of high-grade consumption abroad, all induced a frenzied development in China of an industry producing high-grade

consumption goods. However, the backward connections that would have been needed for a capability to produce these high-grade consumer goods was far beyond the foundation offered by the domestic industry, so that in the end everything had to be imported, from production facilities to produce the final product to intermediary products and down to basic products. The amount of foreign exchange available became the active variable to restrict the extent to which this kind of importation of whole processes could be resorted to.

While being squeezed from two sides, namely by the system and by technology, and while remaining inactive in the "newly emerging industries" because of a shortage of foreign exchange, this is a huge waste of the production capabilities of the domestic industry in these and related lines of manufacture. This waste is most conspicuous in the machine-building and war industries. There is importation on the one hand and inactivity on the other, there is insufficiency on the one hand and surplus on the other. The structural disjunction between supply and demand, with the sluggish supply of resources, has led to truly shocking social waste.

The crucial problem is not only the structural contradiction itself, brought about by the two trends in demand, but rather the conflict in time between the two contradictions. During industrialization in the developed countries, accelerated urbanization, followed by achievement of the historical task of replenishing social capital on the one hand, along with the increase in high-grade consumption, followed by the conversion of the industrial structure to high-grade processing on the other, were two widely separated historical stages. In China, however, both of these waves arose at the same time. In technology, there ensued comprehensive competition for natural resources and for limited savings. This competition manifested itself primarily in two respects: Overtly, investors of all ranks, motivated by profits and in view of the restraints of the organizational system, still preferred the processing industries; and covertly, resources that nominally had been destined for basic industries were continually diverted to other industries, most conspicuously in agriculture and in the steel industry.

The supply gap between basic industry and social capital, brought about by urbanization, and the disjointed state of the industry, brought about by high-grade consumption, were, historically and logically, two different types of transformation processes in the production structure. The former had its start in the structural imbalance, going from imbalance to balance, and the latter had its start in the state of balance, doing away with the original balance and creating a new balance on a higher level. The two types of contradictions in the industrial structure are also different in the direction in which they lead industrial relations. The former starts with the basic industries, transmitting shortages from the back to the front stage, while the latter starts out with the consumer goods industry and transmits shortages from front stage to the back. The simultaneous rise of the two waves led to a

"comprehensive tenseness in the double-drive industrial structure," which is unique to China. In this way, the peculiar changes in the demand structure exercise, through the production structure, a forceful pressure on all other areas of the economic structure.

Conversely, the imbalance in the total volume relations causes a further sharpening of structural contradictions. Although the net influx of foreign exchange and foreign capital has an important effect on closing the structural gap, the frenzied wave of domestic high-grade consumption had the producers, working under distorted market conditions, easily gain huge profits as domestic commodity prices rose continuously. While the incentive of foreign exchange earnings had never been strong, and while the protective customs tariff restricted importation of consumer goods, these industries became even more inward-oriented. The rise of high-grade consumption has undoubtedly also diverted the flow of limited resources to non-key industries, thus aggravating the overall crisis of the basic industries.

At the same time, time-related structural contradictions manifested themselves in spatial friction. The fierceness of the two types of contradictions has shown great disparities among the various branches of China's economy. The contradiction in the industrial structure began to show itself as a regional contradiction that manifested itself, concentratedly, in the friction between the coastal region economy and the inland economy. Particularly after implementing more favorable policies for opening up and for market conditions in the coastal regions in recent years, there was a distinct trend of high profits there that attracted key domestic elements of production to the coastal regions. This raised the pressure on basic industries and the restriction of the economy by foreign exchange to a much higher degree than in the interior. Before formation of an outward-inward cycle and before ending the divisive system, this pressure was bound to shift toward the interior, causing the contradiction between processing industries and basic industries to assume the form of regional friction and mutual blockades. At present, this condition does not tally with the actual anomaly of China's objective natural resources and production potential and the resulting trend of demanding a uniform market.

Revelation of the time-related and spatial contradictions faced by China's industrial structure under pressure from the demand side fully justifies the following conclusion: shortage of social capital and insufficiency of effective technologies are the primary contradictions in China's industrialization. The above analysis clearly shows that the upgrading of our industrial structure is obstructed by two bottlenecks: one is the bottleneck of basic industrial supplies, brought about by accelerated urbanization, and the other is the technological bottleneck, brought about by high-grade consumption. If the contradiction of the first type is not solved, there is no way to quickly and effectively narrow the gap in the basic industries. If the contradiction of the second type is not

solved, China's industrial relations will always remain in a state of disjunction between levels and thereby lose the source of its dynamic energy toward economic growth.

The state of serious deficiencies in basic industries and effective technology supplies explains that China's economy shows the characteristic that in developed economies is called "the double gap." Shortage of domestic savings makes supplementing by a net influx of foreign capital necessary. The gap in technology supplies also requires supplementing by importing foreign technologies. Therefore, it is of the greatest significance to provide the mechanism for infusion of foreign capital as quickly as possible and for importation of new international technologies. However, obtaining external resources is, after all, a supplementary measure, and furthermore, can only be significant under certain conditions. Creating a mechanism for domestic capital formation and technological renewal is still a primary condition. This not only touches on the need for full utilization of domestic resources, but is also a precondition for any effective importation of external resources. We must, therefore, abandon the balanced domestically-oriented model that we have followed for many years and turn to an unbalanced model that tends toward a regional and partly opened up form. But it has to be clearly pointed out that the shift to an externally-oriented industrial structure does not mean that the buildup of the state depends on trade. Because of the huge disparity that exists between the share that could be shifted to the international market and domestic demand, trade conditions are not favorable for products to earn foreign exchange with low added value. Especially the particular complexities displayed in the economy of a large country that is economically backward, and showing extremely poor internal conditions, determine that it is impossible to develop the Chinese economy, if one were to attempt it with a small country's economic model of relying on trade to build up the state. Although there has been a long-standing theoretical argument over the two strategic trends of import substitution and export guidance, in view of China's actual realities, the industrial structure can only be one that integrates domestically oriented and externally oriented factors, and is of a transitional state in which import substitution and export guidance are both taken as of equal importance.

Structural conflicts are crucial obstacles to any smooth progress in development and reform, but industrial structure is not a matter existing in a complete vacuum. Structural phenomena are frequently the result of comprehensive statistics. At the back of these phenomena are institutional changes and other essential characteristics, and these problems are also intertwined with such matters as prices, technological renewals, scale structure, and are engendered in the company of market mechanism. Resolution of structural conflicts must, therefore, also penetrate deeply into the levels of production organization, accomplish stripping away government from industrial organization, raise the extent of organizational

improvements of the market, and promote the effective supply of technologies in the form of microeconomic composites of the key elements of production. This is the only way in which the structural objectives of replenishing social capital and developing foreign exchange earning industries can be accomplished.

## II. Major Substance of China's Industrial Policy

We believe that China's industrial policy should be directed toward the creation of the following situation. A relationship of harmonious coordination must be maintained between the formation of domestic capital, especially social capital, and the large-scale flow of population to poles of development; a stable developmental order must be established domestically between import substitution in the areas of heavy industry and the chemical industry and export substitution in the area of the light and textile industries, as well as in the machinery and electrical appliance industries. A benign cycle must be created between imports and foreign capital influx on the one hand and exports and foreign exchange earnings on the other. Efforts must also be made to establish an industrial order consistent with these moves. For this purpose, speaking from the point of view of implementation, China's industrial policy shall pursue three basic objectives in the coming 8 years (up to the Eighth 5-Year Plan), namely with a bias in favor of replenishing social capital, it shall create an excellent external environment for direct economic activities and influx of foreign capital; it shall enhance market organization, and as a key task transform stock capital; it shall with utmost energy support industries that earn foreign exchange, thus providing the precondition for the achievement of the first two objectives.

### A. Reinforcing the Basic Industries

Considering the possible trend of structural changes in the coming 8 years, reinforcing the basic industries will be inseparably blended together with structural modifications, organizational transformations, and with a steady and rapid economic development. It will become the major problem to overcome in China's transitional phase of sweeping developments, and will even become the focal sector where reform and development will merge. Starting out from China's present condition, there are the following important points to observe in the policy of reinforcing the basic industries:

*Selecting key industries, effecting necessarily preferential investments.* China's basic industries are faced with shortages on all fronts. Looking at the way the norms of the Seventh 5-Year Plan were fulfilled during its first 2 years and at the objective conditions set in the Eighth 5-Year Plan, we see that since domestic savings have been limited and a large influx of foreign capital has not materialized, the only choice left is to develop industrial key points that have an important bearing on other sectors, that are badly wanting, and that are absolutely irreplaceable. Among the industries that conform to

these conditions the first to propose are the electric power, transportation, and communications industries. The electric power industry should consist of predominantly thermal power plants, but where local conditions permit, it should also develop hydroelectric power and nuclear power. The industry should make strong efforts to alleviate more or less within the next 8 years the shortage of electric power and "capture the high ground" of supplying motive power in the industrialization. In order to achieve this objective, a scientific and comprehensive plan for the electric power industry has to be formulated with systematic planning, a plan which will have to comprise consideration of the development and disposition of those branches of industry that manufacture power generation and transmission equipment, also of the coal mining industry, transport industry, and other related industries. The transport and communications industries will have to complete their original railway and communications key construction projects, but in addition must direct their particular attention to the support of the development of the coastal regions with their externally-oriented economies. This means development and perfection of such items of the infrastructure as harbors, airfields, and telecommunication facilities. Efforts should be made to create within the time of 5 years an excellent external environment in portions of the area, attaining a height of development that will stimulate China's national economy. Besides this, key support should also be given to industries providing raw and semiprocessed materials, such as steel and iron and nonferrous metals, also to the chemical engineering industry, and the building materials industry. By means of technical transformation of present enterprises and the spread of already acquired advanced technologies, they should enhance their supplies, quantitatively and qualitatively, and appropriately utilize surplus capacities of the international market to supplement domestic shortages.

*Perfecting the mechanism, normalizing sources of capital.* The value substance in the basic structure is social capital, i.e., the public capital which has its source in and also serves all members of the society. The defective mechanism for replenishing social capital has already had serious consequences. To eliminate this obstructive factor, efforts have to be made in the following directions in order to arrive at a normalized source of capital and a sound system: (1) Clarifying the legal responsibilities between the central government on one side and the provincial, prefectural, municipal, and county governments on the other side for reinforcing the basic industries, and developing their specific key projects at different levels. (2) While ensuring an essentially rational scope and structure of foreign indebtedness, expanding the proportion of long-term foreign loans invested in basic industries. (3) Appropriately expanding the amount of the government's domestic borrowing. (4) Perfecting the system of social guarantees, which would

have the financial organs gain more sources of long-term investments from individuals. (5) Perfecting a system of a key development fund and an investment bank of public financial character.

*Determining shadow prices, effecting a transition in the price mechanism.* The inordinately low prices for basic products have an adverse effect on the development of the entire basic industry, but it is impossible to try to overcome the three great impediments: insufficient investments, insufficient breadth of scope, and too brisk a demand, merely on the strength of effects from the price mechanism. Because the basic industries are an area that has all along been restrained by market mechanism, it has always sought to achieve a balance between effective internal business management and stable development of the macroeconomy through direct management by the government or through strict controls. A more feasible method would be to effect, simultaneously with the reform of the enterprise management system, and through an evaluation and application of shadow prices, a transformation with key targets and step by step in the pricing mechanism of basic industries and avoidance of a spiraling currency inflation.

*Pursuit of returns of scale, accelerating technological progress.* In the last few years, the reaction of the market mechanism has forced local governments to invest preferentially in basic industries. This explains that China's industrial structure has already a "self-organizing function." Actively guiding this state of things, helping the dispersed investors overcome such shortcomings as the dispersed distribution, low level of technology, and too narrow a scope, and determining the necessary scope and technological standards, is also an important content of policy.

#### **B. Development of Industries Best Capable of Earning Foreign Exchange**

As far as China's economic development is concerned, earning foreign exchange is not only a consideration evoked by foreign trade, but also a matter of rediscovering and reevaluating our developmental advantages in the even larger scope of the international economic structure. Determining a policy for the development of industries capable of earning foreign exchange touches on two subjects, namely choosing entities that will earn foreign exchange and improving the environment for earning foreign exchange.

When selecting Chinese industries that are to earn foreign exchange it is necessary to simultaneously pay attention to two mutually related criteria. First, we must decide, from the angle of supply, and according to the resources China is endowed with, on such industries that are favorably placed to enjoy more benefits from the international division of labor. Second, on the basis of an analysis of supply, from the angle of demand, and according to the changing trend of distribution of profits in international trade, we must ultimately determine the

industry that throughout China is best placed to earn foreign exchange. It is true, participation in international trade, and observing the static division of labor, determined by the supply of the key elements of production, can be much more profitable than production in isolation. However, the amount of profit that a country gains from international trade is not merely determined by its trading motives, but much more by trading conditions influenced by the strength of demand and the supply factors. Availability of the key elements determines the start of trade; trading conditions determine the share in the trade profits. In a historical analysis of our transition from the static division of labor, determined by the supply of key elements, to an active trading trend, we will discover the following facts: Exporters of different types of goods will show a wide disparity in profits, due to the difference in trading conditions. Under favorable trading conditions, international trade can become the generator for a country's economic growth, while under unfavorable trading conditions, international trade can, on the contrary, enlarge the gap between the country in question and other countries. Selection of China's principal industries for earning foreign exchange must, therefore, not only pay attention to China's endowment with natural resources, but must also make a comprehensive comparison of trading conditions.

For China's short-range objective of earning foreign exchange, placing emphasis on the export of traditional labor-intensive products is a necessity. Especially after the large devaluation of the U.S. dollar and the rise in the value of the Japanese yen have correspondingly increased labor costs in the newly industrialized countries of the Asian-Pacific region for products which they traded directly to the U.S. market, the resulting partial reorganization of the international industrial structure has provided us with a profitable opportunity. China's traditional labor-intensive industries have the advantage of low costs and maturity of products, which give us the possibility of taking advantage of this one-time opportunity.

However, from a medium-range viewpoint, there are many problems involved if we were to make exports of traditional labor-intensive products our top "break-through" exports. First, following the continued rise in the level of science and technology, the accelerating substitution of labor by capital and technology in the composition of industrial resources, continuously reduces the proportion of traditional labor-intensive products in the world's import-export commodity mix, and their share of the market is progressively declining. Even if they are nominally traditional labor-intensive products, their future exports will also have to rely on being supported by even more capital and technology-intensive measures. Second, trade conditions for primary-phase processed products have deteriorated, and their added-value starting point has also been lowered, because multiple processed manufactured goods rely to a lesser extent on raw and semiprocessed materials, and for other reasons, so that there is less income margin for primary products. On the other hand, industrialization

requires simultaneously large-scale importation of technologies, equipment, and even more so raw and semi-processed materials, and a large drop in the exchange rate can aggravate the trading conditions. Third, the post-war developmental trend, particularly in recent years, shows that a comparison of the export prices of low-processed products and of multiple processed products indicates an even larger fluctuation. Making low-processing industries the major agents for earning foreign exchange from exports will, therefore, increase the instability in China's developmental processes.

Starting out from a comprehensive trend analysis of supply and demand, we must place even stronger emphasis on earning foreign exchange during the intermediary period on machine building, electronics, and fine chemical industries as comprehensively technology-labor-capital-intensive industries. Apart from the reasons mentioned earlier, we must also recognize that China is endowed with resources of major significance, differing in this respect from other developing countries with an equal level of income. China not only has an abundant manpower resource, but also a substantial potential in its processing industries, particularly in its machinery and electric appliances industries. Viewing the long-range trend in the world's economic development, we see that the world economy of the 1990's will emerge from its low state to reach a new peak, which will create huge markets for machinery and electrical products. From the standpoint of strategy, fostering industries which are favorably placed to conform with the great restructuring of the international industry in the 1990's is now already of special significance.

As to the perfection of the environment for foreign exchange earnings, the following points have to be emphasized: First, the competitive environment of enterprises. Just as in getting recognition for the preferred one among several similar theories, every article that is to compete in the international market, apart from certain extremely rare resources, must first have achieved maturity in the competition of the domestic market. Moving a product from the domestic into the international market are two inseparably linked stages. In the development of large-scale projects that are to earn foreign exchange, it is impossible to bypass the competition of the domestic market. To be successful in this respect, it is necessary to give a prominent place to the reform of the enterprise management mechanism and to nurturing markets. Second, we must control the domestic increase in high-grade consumption and the rising tendency in high-grade commodity prices, as the expanding domestic demand is driving commodity prices up and is thus bound to exert a stronger attraction for export products to be diverted into the domestic market. Third is the improvement of the earlier mentioned "hard environment," mainly the reinforcement of basic industry. Finally, it is the reform of the system of foreign trade administration itself. Besides this, certain economic parameters, such as exchange rates, customs

returns, prices, subsidies, and quotas, as well as related policies, will have to be amended, and new advances will have to be made in instituting a financial mechanism and also a sound legal system.

### C. Regarding Efforts To Improve Market Organization

China's economic structural reform is an organizational process of gradually transforming the form of its industrial organization, which in length and breadth is now determined by the structure of the government's administrative organization, into a market organization under an industrial order and restrictions determined by the government. But because of the present cohesion between government and the industrial organization, and the restraints on the mobility of key resources in this process, on the one hand, and because of the poorly organized market, on the other hand, the results so far have been excessive competition and monopolies. Neither government intervention nor market mechanism could exercise their normal functions. In whatever direction, it adversely affected the rational distribution of resources, led to insufficient effective supply of technologies, and caused dislocation of link after link in related industries. To cope with this situation, the fundamental substance of our policy of industrial organization must be: creation of a market entity, intensified efforts to improve market organization, and transformation of capital holdings with emphasis on focal points.

*Creating a market entity, accelerating mobility of resources.* The market entity, as the composite of all market relations, directly determines the mobility of resources. To solve this question it is first necessary, as in the past, to split apart government and industrial organization. Aiming at the present state of China's industrial organization, we must emphasize the essential idea that everything an individual can do well, enterprises must not do; everything that is suited to be handled by individuals and enterprises, the government should not do; everything that a lower ranking government can do must not be done by a higher ranking government; whatever cannot be achieved by the units of various economic interests or by lower ranking governments, must be accomplished by the central government. Second, creation of a market entity should be materialized through further experiments and clarification of property relations of various forms. We must actively induce development of private business, promote the shareholding system, and effect the transition of state-run enterprises from the production and business contract system to the state-owned property use contract system. Third, together with the perfection of a social guarantee system, we must accelerate talent mobility, and have our labor force become truly a resource that does not belong to any owner. Finally, we must perfect a systematic official or nonofficial evaluating and intermediary organization for the shifting of such resources as labor, technologies, and capital holdings in order to provide the necessary conditions for the long-range development of the market entity.

*Intensified efforts to regulate market organization, creating a state of competition between the large enterprises.* Because of the two intertwined contradictions in China's industrial structure mentioned earlier, an unrestricted competition is not beneficial for the formation of a rational industrial order. Under the present circumstances, the correct choice would be direct intensified regulation of a market organization. First, developing enterprise conglomerates will not only fully utilize the economies of scale, but, more importantly, will form a controlling relationship of the large enterprises in relation to medium and small enterprises and also to miniature enterprises, and will raise the extent or organizational perfection of the market. Second, perfecting organization and functions of enterprise conglomerates. Apart from expanding the autonomy of large enterprise conglomerates in monetary and foreign trade affairs, attention must be paid to formation of a comprehensive technology-developing strength that extends over the entire range of industries. Third, strengthening teamwork cooperation between government and large enterprises, establishing a systematic cooperative organization between government, enterprises, and consumers, suppressing illicit monopolies, and promoting more democracy in the economic decisionmaking processes of the government. Finally, toward small enterprises, we must pursue a policy of further stimulating competition, have them attain capability and the environment to have a relationship with the large enterprises of mutually promoting each other's affairs and of mutually supplementing each other's efforts, as well as enabling them to develop by means of their own strength. Medium and small enterprises which have demonstrated great ability in the competition must be supported to the utmost, and we must ensure that such enterprises will be allocated resources commensurate with their business operations. Besides, as market conditions mature, we must not lose the excellent opportunity to perfect the government's indirect control measures over the macroeconomy.

With special efforts directed toward crucial points, capital holdings should be transformed. According to the main tendency of contradictions and demands in China's industrial structure, we must start out from the aspect of unified planning at the three levels of structural transfers, organizational transformations, and technological renewals, and must institute import substitution and a transition to domestic production of motorcars, large-scale mechanical and electrical plants and equipment, large-scale integrated circuits, and of the most important durable goods, so as to bring the potential of China's war industry and mechanical and electrical equipment manufacturing industry fully into play, making them the poles for the absorption and spreading of technologies and having them develop in an externally-oriented direction.

The overall tenseness throughout the double-drive industrial structure, brought about by the peculiarity of contradictions in social demands, determines that the choice of dominant industries must favor the basic

industries and the new types of labor-intensive industries that bring in foreign-exchange. This state of a dual development in the industrial structure puts great pressure on the industrial organization. Realization of industrial policy relies on the formation of a contingent of the highest quality of industrialists and government economic administrators. How to create these two important "manpower assets" is a consideration that should take preference even before consideration of any of the other above-stated policies.

#### Footnote

1. See Li Boxi [2621 0130 3305] et al., "Tentative Study of China's Industrial Policy" in "Research Reports of the State Council's Center for Development," No 12 (1987).

### FOREIGN TRADE, INVESTMENT

**Trade System Reform With Soviet Bloc Proposed**  
40060513 Beijing GUOJI MAOYI  
[INTERTRADE] in Chinese No 3, 27 Mar 89 pp 12-15

[Article in the FORUM: "Tentative Proposals on Reform of China's System of Trade With the Soviet Union and Other Eastern European Countries"]

#### [Text] I. Some Basic Assessments

China's system of trade with the Soviet Union and the Eastern European countries as characterized by inter-government trade agreements played a decisive role in history and still plays a pivotal role today. But affirming its past role does not imply that it should or will continue to exist. In fact, our present system of trade with the Soviet Bloc is seriously flawed. It will undermine further development of our bilateral economic and trade relations.

One, the system of inter-government trade agreements is the product of a definite historic period. In the wake of reform of the economic systems in China and the Soviet Bloc, especially the reform of the foreign trade systems, it is inevitable that monopolies will be crushed and the economies will be decontrolled. Under the circumstances, it is obvious that inter-government trade agreements are no longer compatible with the restructured economic systems on both sides. This trade agreement system which is one of the products of the highly centralized planned economy violates the principles of our new economic system and its application has revealed many intrinsic limitations.

Two, the system of inter-government trade agreements mixes government with enterprises and mixes management with operation. Under the system, the countries rely on the governments' long-term trade agreements and annual barter protocols to determine what the foreign trade enterprises and manufacturers should export or import. The government's decision replaces enterprises'

economic decisions; administrative and mandatory plans replace enterprise's profit maximization; the government departments are exceeding their functions. Consequently, despite the long-term trade agreements, annual protocols and contracts have become difficult to hammer out. Many contracts are not fulfilled, and it has become increasingly difficult to execute the agreements. The principle of balance of trade is violated by actual import-export unbalance.

Three, inter-government trade agreements thwart bilateral trade expansion and undermine its healthy development. Under this system, if one party to an agreement has an export problem or has deliberately over-estimated its export capacity and defaults on the contract, it would upset the balance of trade, and as a result, the side with a trade surplus is forced to extend a zero-interest or (if the adjustables in the agreement are exceeded) low-interest loan to the side with a trade deficit. This situation will also upset the balance in the following year when we either will be unable to maintain up or increase the trade volume, or must agree to such a high trade figure that the outcome is bound to be disappointing. This is one of the limitations. Another limitation is that this form of trade often tends to protect the backward, slower selling products. When the governments execute the trade agreements, neither side is willing to export the highly competitive goods to the other side; those goods are destined for markets in the West to earn convertible foreign currencies. In the long-run, this kind of bilateral trade will lose vitality, and it will be impossible to tap even the greatest trade potential.

#### II. Evaluation of Several Reform Ideas

Reform of China's system of trade with the Soviet Union and the Eastern European countries is imperative. For this reason, many comrades have offered valuable ideas and suggestions. They generally fall into the following areas:

1. Establishment of trading companies that do business with the Soviet Union and the Eastern European countries and handle all import-export commodities which the government has included in the trade agreements. Since China's trade with the Soviet Bloc make up only about 10 percent of our total trade, and since no spot foreign exchange is used, this trade zone should be separated from other trade zones. This will facilitate uniform import-export planning and accounting which will require us to set up only one office, and this in turn will facilitate unified management and coordination, and export profits and import losses can be detected easily, and they will reflect the economic efficiency of trade with these countries and will help us fulfill the agreements.

But this program still relies on state monopoly of foreign trade and requires highly centralized mandatory planning and monopolistic operations as preconditions. They violate our principle of decontrol which is one of



the basic principles in China's reform of the foreign trade system. Meanwhile, this program does not abolish the existing system of inter-government trade agreements and cannot eliminate its defects. If specialized trade companies are set up, branch companies will be needed everywhere to guarantee the supply of goods. Thus, from the point of the direction of reform of the foreign trade system and the long-term development of bilateral trade, this proposal is feasible but not practical. If implemented, the drawbacks may outweigh the benefits.

2. Parcelling out the import and export contracts with the Soviet Union and the Eastern European countries to several provinces, cities, and autonomous regions at the same time (only the export contracts are parcelled out at this time). This program will link our system of trade with the Soviet Bloc to the present 3-year foreign trade contract system. It will facilitate management of the entire foreign trade system and reduce the state's financial losses.

But this program also fails to address the core problem in our system of trade with the Soviet Union and the Eastern European countries. First, when trading with these countries, many import and export commodities are still regulated by the state. If we parcel out the contracts to the localities, there is little the state can do if the localities fail to balance imports and exports. Second, a more serious consequence may be that, putting their own interests first, the localities will export more and import less, and this will make the agreements more difficult to fulfill and may produce a huge trade surplus which will adversely affect our economy.

3. Proposal of setting an internal settlement price for Swiss francs to clear the accounts and adjust the profits and losses of import and export and balance their cost and benefit. This proposal in essence tries to disassociate the internal settlement price of Swiss francs from their spot exchange price and adjust the settlement price between Swiss francs and renminbi according to the cost of our import and export trades with the Soviet Bloc. In the process, we can divert some of the export profit to pay for imports based on this settlement price.

This program maintains the status quo in our trade with the Soviet Union and the Eastern European countries and tries to manipulate the internal settlement price. Reducing the profit of the exporting enterprises via the internal settlement price will jeopardize exports to this trade zone. Meanwhile, relying only on the exchange rate as a lever makes it very difficult to balance the cost and benefit of import and export. The importing enterprises may have an edge, but it still cannot make up for the losses incurred by importing.

4. Completely restructuring the system of trade with the Soviet Union and Eastern Europe and abolishing the inter-government trade agreements and use spot exchange instead.

The merit of this proposal lies in its elimination of the defects of the inter-government trade agreements and its separation of government from enterprises and management from operation. It is consistent with the direction of this country's reform of the foreign trade system, and it gets rid of the burden of long-term trade surpluses which are of no real use to us. It encourages enterprises on both sides to fulfill the contracts and improve the quality of the products and makes both sides more competitive.

If we analyze this program rationally, however, we will realize how extremely difficult it is to carry out. First, today neither the Soviet Union nor the Eastern European countries will agree to cash trade using spot exchange. This is due, in addition to the force of habit and to their preference for trade agreements, primarily to their chronic shortage of foreign exchange, their lack of potential exports to the West, and their heavy foreign-debt burdens (statistics show that the Soviet Bloc owes the West as much as \$120 to 125 billion; their debt to export ratio is as high as 215 percent). Forecast predicts that these countries will remain in the peak debt redemption period from the 1990's until the end of this century, and so they neither want nor can switch from the traditional barter trade to cash trade using spot exchange. China is facing similar problems as well. Second, if we enter into spot exchange trade rather than seek balance, which side, China or the Soviet Bloc, can take the pressure of trade deficits? Obviously, this form of trade will prompt both sides to get more foreign exchange from the other side, and this will result in more exports and less imports. In fact, if China opts for cash trade with spot exchange, we will have a huge trade deficit with Yugoslavia. This situation cannot sustain over a long period of time. If we switch entirely to spot exchange trade, China's trade with the Soviet Union, and particularly with Eastern Europe, will decrease, although not uniformly. Because China and the Soviet Union supply each other's need in trade, the trade volume can be sustained; besides, supplemented by other forms of trade, trade with the Soviet Union can be kept up and may even expand and grow. But trade with the Eastern European countries will be less optimistic. China will not spend spot exchange to purchase ordinary mechanical and electrical apparatus nor will they spend huge sums of foreign exchange to purchase our light and textile consumption goods. Thus, reforming the bilateral trade system and replacing inter-government trade agreements with spot exchange trade may not be feasible for some time to come. If China insists on this option, it will lower the trade volume in this trade zone.

### III. A New Concept

1. The premise of reform of the system of trade with the Soviet Union and the Eastern European countries:

We must understand that reform itself is not the final goal. Our goal is to promote the development of bilateral trade relations. The premise of reform of the system of



trade with the Soviet Bloc is to promote the multi-faceted, multi-level, and multi-channel development of bilateral economic, trade, production, and technological cooperations and keep the bilateral economic and trade relations at a healthy, proper level by making changes in the system. Of course, we should also realize that there are risks in any kind of reform program; we will run into many problems and difficulties at the beginning, and the trade volume may decline somewhat. We must be fully aware of these possibilities.

## 2. Reform of the way we do business:

Inter-government trade agreements with the Soviet and Eastern European countries should be abolished. Long-term trade agreements signed within these 5 years should not be renewed upon expiration. Meanwhile, the annual barter agreements should gradually be abolished too. This implies that the producers of commodities and the managers will once again play the dominant role in the bilateral trade, and the government will no longer hand down mandatory import-export plans. Enterprises will operate as enterprises, and they can decide on the form of trade in accordance with their own needs and possibilities. At the same time, departments and localities doing business in this trade zone should be given more management rights, and different forms of trade should be permitted to supplement the government trade agreements until the latter is finally abolished.

## 3. Reform of the settlement method:

In consideration of the needs and the possibilities of long-term development, we should set uniform exchange rates with the Soviet Union and other Eastern European countries in that trade zone. That is, we should establish a direct price ratio between the renminbi and the currencies of the Soviet Bloc countries. In this way, if there is a trade surplus, the surplus money can be spent in the other country to buy goods or invested directly or used to set up joint-ventures, purchase the other country's stocks, and develop tourism or pay for goods and services with that country's currency. At present, the Soviet Union and Czechoslovakia have adopted this method to settle their accounts, and they may promote this system among the CEMA countries. In addition, there is a non-trade exchange rate between the currencies of the Soviet Union and the Eastern European countries; this exchange rate is not linked to the convertible currencies of the West. Hungary and Poland, which are parties to a general custom and trade agreement, have adopted this method. During the second quarter of 1988, Hungary set the exchange rate of \$1 to 47 forint and 1 ruble to 17 forint; the price ratio between the U.S. dollar and ruble is 1:3. In Poland, \$1 equals 410 zloty and 1 ruble equals 170 zloty; the price ratio between the U.S. dollar and the ruble is also 1:3. Both Hungary and Poland practice a market economy which is controlled by planning, similar to China's. They determine the exchange rate between their own currencies and the Soviet Union's currency based on the purchasing power parity theory. China can

do the same and set exchange rates with the currencies of the Soviet Union and the Eastern European countries and integrate the trade and non-trade exchange rates. This will eliminate all the defects of settling accounts in Swiss francs at recorded prices through remit and transfer. It will facilitate the smooth development of economic, trade, technological, production, international tourist and other mutual cooperations. Moreover, the biggest advantage of direct exchange of currencies is that it eliminates the use of foreign exchange which is very scarce when making payments and we can avoid any trade imbalance problem. In addition, the Soviet Union and some Eastern European countries have suggested gradually turning their currencies into convertible currencies; some have even set a timetable. Once those currencies become convertible, China can create a pricing package and set exchange rates, and we can conveniently convert the present method of trade settlement into spot exchange settlement. This probably is a more stable reform measure, acceptable by both sides. The only difficulty lies in the bilateral negotiation, but as soon as this is resolved, all other problems will solve themselves.

## 4. Reform of the pricing method:

The practice of buying high and selling high must be changed. First, we should price the products according to international market prices and give the importers and exporters a correct price signal and allow them to compete under fair and equal conditions. For this reason, before we peg our currency to the currencies of the other side, we should link the export profits and import losses and set up an "export regulation fund" and balance our own import and export and create an internal self-regulating mechanism when doing business with this trade zone.

## 5. Reinforce the mechanism which allows enterprises to take responsibility for their own profits and losses when trading with the Soviet Union and the Eastern European countries:

Prior to reforming the trade agreement system, we should reinforce the mechanism which lets enterprises take responsibility for their own profits and losses to facilitate the fulfillment of the long-term agreements in the remaining 2 years before they expire. The specialized foreign trade corporations should have domestic trading rights. We should learn from Japan's comprehensive trade agencies which handle a fixed proportion of both domestic and foreign trades. Hungary has solved this problem too. In 1988, Hungary combined its Ministry of Foreign Trade and its Ministry of Commercial to form the Ministry of Trade and transferred some of the functions of the Administration of Commodity Prices to the Ministry of Trade, and subsequently, has fairly successfully balanced its imports and exports and solved some other problems, and the entire circulation realm has become more open. Today, some of China's frontier trade companies and local trade companies have been

fairly profitable in trading with the Soviet Union and the Eastern European countries. This is because they have acquired domestic and foreign sales rights. They price their products based on market prices and reduce the number of middleman, and the final consumers find their prices reasonable.

6. We need to take active steps to develop more frontier trade and local trade with the Soviet Bloc and forge a direct relationship between enterprises on both sides and develop different forms of cooperation and let them play a bigger role in the bilateral trade. To achieve this goal, we probably should set up a Soviet Bloc trade association to handle the coordinating and organizational tasks. In particular, at this stage, we must let the local foreign trade companies know more about available channels and trade partners in the Soviet Union and the Eastern European countries and keep them better informed to promote the healthy and steady develop of different ways of trading with the Soviet Bloc and let them play a bigger role in the bilateral trade.

#### **Ways To Improve Foreign Debt Management**

40060531 Beijing JINGJI LILUN YU JINGJI GUANLI  
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[Article in "Anti-Inflation Measures" column by Zhang Guanghua 1728 0342 5478 of the State Administration of Foreign Exchange: "Managing Foreign Debts Better in an Inflationary Situation"]

[Text] In a decontrolled economy, foreign debt policy becomes an important part of the nation's macroeconomic policy. Foreign debts are an economic variable that cannot be overlooked in a modern economy. They can help make up for inadequate domestic construction funds and promote the development of the national economy, but they can also obstruct proper economic functions and disturb economic order. Basically, inflation is either demand-pull or cost-push. In either case, increasing foreign debt will further fuel the economy. In a country beset by hyper-inflation, a tight domestic financial and credit loan policy will lead to surging demand for foreign loan funds. If we fail to tighten the foreign debt policy, the huge influx of foreign loan funds beyond what the national economy can repay will become an exogenous variable which will aggravate inflation. Eventually, after a period of stagnation, a new round of inflation not only will further increase the demand for foreign loans but the higher rate of inflation will depress the real exchange rate of the domestic currency against foreign currencies, and this will exert pressure to depreciate the official exchange rate. Substantial depreciation of the domestic currency will raise the cost of repaying the principal and interest of the foreign loans. The added debt burden can easily turn into a debt crisis. In addition, depreciation of the currency raises the prices of imported raw and processed materials and domestic products, and this will exacerbate inflation at home.

Thus, as we tighten our fiscal and monetary policies today, we must also adopt a tight foreign debt policy and coordinate different aspects of our macroeconomic policy to combat inflation.

Tightening the foreign debt policy means strengthening foreign debt management; it means keeping the increase in the scope of foreign debts under control, improving the loan composition, putting the foreign loans to better and more efficient use, formulating a proper loan repayment plan, and insisting on repaying the loans on time.

*First, keep the increase in the scope of foreign debts under control.* The scope of a nation's foreign debts is constrained by, among other things, the periodic demand for foreign loans to finance domestic construction as well as by the availability of loan funds in the international fund market and the nation's own ability to pay its debts. A nation's foreign debts should be limited to the amount needed to make up fund deficiencies to meet the demands of its reasonable rate of economic growth. The ability to repay the foreign debts is the most critical factor determining the extent of indebtedness. Today, the two indicators most used to evaluate a nation's debt level are: (1) the debt ratio which refers to a nation's debt balance relative to its total export of goods and services during the same period; (2) the debt retirement rate which refers to the payment of principal and interest as a percentage of the export of goods and services during the same period. Generally, the debt ratio should not exceed 100 percent and the debt retirement rate should not exceed 20 to 25 percent. Debt crisis looms if these two indicators are exceeded. Although China's debts have not exceeded the security boundary, there are indications of overheated demand for foreign loans; therefore, we must control the scope of foreign debts more tightly. We must estimate, using scientific methods, the country's short- and long-term ability to repay the loans and set a proper debt retirement rate which is consistent with China's conditions today, and by finding the optimal quantitative limit which will be the quota that limits our extent of indebtedness, we should formulate and perfect a new foreign borrowing plan. The state should formulate an annual plan as well as periodic mid- and long-term borrowing plans based on the state of economic development and our ability to pay. Once the annual plan is formulated, it should be sent down to the local governments and departments, and the quota may not be exceeded without prior approval. The mid- and long-term plans should be adjusted as economic conditions change. At present, we should examine our foreign debts to determine if the scope is proper and if the repayment plan is compatible with our ability to pay. We must understand that our long-term stable economic development must depend ultimately on the country's own manpower, material resources, and financial capability; foreign funds can only serve as a supplement. In addition, we must prohibit improper borrowing activities at the microeconomic level. In the absence of proper borrowing behavior at the microeconomic level, a country's macroeconomic control of foreign debts cannot

succeed. Recently, some enterprises, departments, and even local governments have abandoned their self-balancing mechanisms and ignored their own long-term interests and the country's interests as they try to borrow money, and without prior approval, they have entered into foreign loan agreements on their own. Some have already exceeded the loan quota set for them; some use foreign loans to participate in foreign exchange regulations; some use foreign loans as foreign exchange collateral for renminbi loans. These activities not only expand the scope of foreign debts but also increase the demand for renminbi. The state's relevant departments should stop these improper borrowing activities; if necessary, economic and disciplinary sanctions should be imposed.

*Second, we need to improve the foreign loan composition.* A good foreign loan composition can lower the cost of borrowing, ease the peak payments, avoid foreign exchange risks, and generate more benefits. Efforts to strengthen the management of the foreign loan composition should focus on the following:

(1) Management of the mix of ways we borrow money: this refers to the mix of different kinds of loans. Developments in international credit loan relations have made possible different ways to borrow money, for example, bond issuance, lend-lease, individual project loans, export credit, consortium loans and so on. We should study in-depth the pros and cons of each type of loan and select an optimal mix of loans so that our foreign debts are not only safe but also beneficial. Today, among the different types of loans, foreign commercial loans make up a fairly large percentage; they rank first in terms of the total value. International commercial loans are generally short-term, high-interest loans; the risk of this kind of loan increases as volume increases. China has approved setting up some "windows" to handle foreign borrowing and bond issuance. Each window should choose one or two reputable financial institutions to handle the foreign loans; otherwise, many financial institutions will swamp the international loan market, and the lack of experience and essential management know-how of some of these financial institutions can damage our reputation overseas. The relevant managing departments should pay closer attention to the examination and approval of borrowing in the international market with regard to the interest rates, loan terms, and the choice of markets. We need to coordinate our activities in the international market to prevent too many financial institutions from borrowing in the market at the same time.

(2) Management of the mix of foreign loan interest rates: this refers to the mix of variable-rate loans and fixed-rate loans. If the international monetary market is unstable, variable-rate loans are more risky. In general, we should try to secure fixed rates for mid- and long-term loans. From the immediate standpoint, the cost of such loans may be higher, but in the long run, the cost may actually be lower. As for short-term loans, if the interest rate is falling, we should obtain variable-rate loans, and vice

versa. In this way, we have taken the initiative to prevent the change in interest rates from adding to our debt burden. Most of China's foreign debts today are fixed-rate loans, but as we take out more and more commercial loans, the percentage of fixed-rate loans has declined. The relevant departments should keep an eye on this and take appropriate steps to prevent the rapid increase in the proportion of variable-rate loans.

(3) Management of the mix of foreign-debt currencies. This refers to the mix of foreign currencies we borrow. At present, the international monetary market is very unstable. The exchange rates between the U.S. dollar and the Japanese yen as well as the Deutsch mark have been volatile. If China's foreign debts are made up of only one currency, we will run serious exchange rate risks. The mixture of foreign-debt currencies should be based on exchange rate expectations, and it should also be compatible with the mix of foreign currencies we use in our import-export trades and the currency we have in our international currency reserve. We should borrow different currencies to disperse the exchange risks so that the debts have a proper, more diverse, currency-mix.

(4) Management of the structure of the loan-terms: this refers to the mix of short-term loans and mid- and long-term loans. The International Monetary Fund has designated loans of more than one year as mid- to long-term loans; loans one year or less are short-term loans. It is generally accepted in international community that it would be safer to keep short-term debts to less than 25 percent of all debts incurred. China had a substantial percentage of short-term debts back in 1985, but they are now under control, and we have kept them within fairly reasonable limits. But increasingly, short-term loans are becoming longer-term loans and some enterprises and departments are putting short-term loan funds into fixed asset investments and not circulating them as current funds. Such practices make debt retirement more difficult; they fuel the already overheated economy and undermine the implementation of anti-inflation policies. For this reason, the relevant departments should supervise more closely the short-term loans in hand and prohibit their use as long-term funds. At the same time, they should try to handle future short-term loans better to enhance China's ability to deal with emergencies in the international monetary market.

*Furthermore, we have to put the foreign loans to better and more efficient use.* One of the main causes of inflation in China is the poor economic structure. Where we put the money we borrow from other countries affects the extent we can support the long-term, steady, and balanced development of the national economy. That decision must be consistent with the nation's economic development strategy and industrial policy.

Foreign loans should be put into the primary sector to fund social and economic development: China's communications, energy, electric power, agriculture, and some other sectors have always been fairly backward and have

never been able to fully satisfy the needs of economic development. We should be more aware and spend more of the long-term preferential loan funds on developing the infrastructure sector to provide a better economic environment to develop the other sectors. Many of China's foreign loans have been used on heavy industry and communications and transportation, but in recent years, more and more borrowed funds have been invested in the hotel and tourist industries. This has been one of the causes behind the bloated investment and demand. Furthermore, foreign loans should be used to import advanced technologies and equipment-type industries and on technological transformation projects. But we must not overlook the following problems: (1) we must avoid importing materials recklessly and redundantly, a serious problem remaining today that has increased our foreign debts needlessly and has affected the development of enterprises; (2) we must complete the projects, putting them into operation in a timely manner while learning and digesting new technologies brought in from abroad—otherwise, it will affect our solvency; (3) while we import technologies and equipment from overseas, we must strive to rely on Chinese-made raw and processed materials (a substantial part of our total foreign exchange expenditure is spent importing raw and processed materials, forcing us to be more dependent on the outside world).

Aside from these, we should also use the foreign loans in projects that can enhance our ability to earn more foreign exchange. In particular, commercial loans and centrally borrowed money that must be repaid by localities should be used on projects that can earn foreign exchange as much as possible. The ability to repay our foreign debts depends mainly on our ability to generate income through exports. To make sure that the foreign debts can be repaid on time and to avail ourselves of the continuous use of foreign funds, we must match our borrowing to our ability to earn foreign exchange and make sure that projects funded by borrowed funds are solvent.

In guiding the use of foreign loans, we must improve management to make sure that foreign loans are used efficiently. First, we must put the foreign loans to more efficient use and coordinate the projects we have brought in. Projects which utilize borrowed funds must be carefully evaluated and be thoroughly coordinated with other elements such as renminbi funds and construction materials so that the borrowed money can be put to good use as soon as it arrives. Second, we should improve labor productivity and product quality and put the borrowed funds to use where they can earn more foreign exchange. The benefit of foreign loans is reflected in higher foreign exchange and renminbi earnings. Higher foreign exchange earning can be guaranteed only by higher labor productivity and better product quality. Third, we must make use of idle foreign loan funds and circulate that money to generate some benefits. Some projects are long-term projects and so a portion of the borrowed funds are idle at the moment. We should permit the

financial institutions to borrow those funds on short-term basis or allow interbank lending and borrowing to circulate some of those funds. Fourth, we should conduct a general or a sample survey of the performance of the foreign loans and add a foreign debt efficiency indicator to our foreign debt statistics monitoring system to build a sound foundation for enhancing the management of the efficient use of foreign loans.

*Finally, we must adhere strictly to the principle of repaying our debts on time to ensure that we can continue to enjoy the preferential terms when bringing in foreign funds in the future.* As far as the state is concerned, it must have prompt and accurate information about when and how the money borrowed by the localities, departments, and enterprises are to be repaid. As for the borrowing units, they must have a definite loan repayment plan. Implementing the debt responsibility system can guarantee timely repayment of loans. Based on how a loan is repaid, China has separated the loans into loans borrowed and repaid by the state, loans borrowed by the state but repaid by the localities or units, and loans borrowed and repaid by the localities or units. China's basic principle with regard to foreign debts is whoever borrowed the money is responsible for repayment. The state has stipulated that if a borrowing unit fails to fulfill its obligation to repay a loan, the foreign exchange management department may withhold that unit's money to repay the loan or allow another managing department to guarantee payment; however, many foreign bankers have come to regard all loan payments by China as government approved and that the state is responsible for payments. We must implement the debt responsibility system and change the foreigner's idea that in China we all eat out of the "same big pot" of national debt. The debt responsibility system can put pressure on the borrowing units and check their excess demand for foreign loans and make foreign loan utilization more efficient and reduce the state's burden.

Establishing a sinking fund is a good way to enforce the debt responsibility system. The sinking fund resembles in nature the federal reserve fund in the commercial bank system of the West. The sinking fund may be set up at the central and local levels. The central level takes care of the centrally borrowed and repaid loans, and it can be funded by withholding a fixed percentage of the money borrowed by the various departments. The local level takes care of loans borrowed and repaid at the local level. It can be funded by withholding a fixed percentage of the money borrowed by the local governments and units. It is possible, however, that with this system, some units and departments may come to rely on this fund to repay their debts. There are technical problems which we need to study more carefully.

#### **'Mixing' Foreign Trade Strategy**

40060512 Beijing GUOJI MAOYI WENTI  
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[Article by Huang Jingbo 7806 7234 3134: "China's Foreign Trade Strategy Should Be a Mix of Import Substitution and Export Drive"]

[Text] I. Reviewing China's Foreign Trade Strategy

When the PRC was founded, it adopted a domestically-oriented economic development and foreign trade strategy aimed at creating a self-sufficient economy. Given the internal and external economic environments at the time, it made sense for a large developing nation such as China to pursue what was basically a domestically-oriented economic development strategy. Unfortunately, our understanding of this kind of development tended to be one-sided and extreme. We failed to change our strategy in a timely manner primarily for the following reasons: First, in the early days of the republic, we had little experience and copied almost mechanically the isolated, self-circulating Soviet model developed under a specific set of circumstances. Even today, 10 years after reform and the open policy began, we cannot say that we have fundamentally put an end to this pattern of isolated, self-circulating development. Second, China is a huge country, impoverished and economically backward. After the revolution triumphed, it was faced with all kinds of internal and external pressure. The desire for change and yearning for government stability were acute. Meanwhile, the imperialist blockade and the deterioration in Sino-Soviet relations convinced the masses and cadres that change and development would come about only through self-reliance. And, compared to the pre-liberation period, we did indeed achieve a good deal through self-reliance. Practice and understanding thus confirmed each other, reinforcing our disposition toward domestically-oriented development and national isolation. Third, even more important were ideological reasons. The people of China, whose tradition is the rule of man, worshipped authoritative figures blindly and came to regard an exaggerated form of self-reliance—domestically oriented development behind closed doors—as the only way out.

If the imperialist blockade in the early days of the republic closed the door to the West for us, the deterioration in Sino-Soviet relations closed the door to the East. Economic blockades by East and West closed the door from the outside, while our own one-sided, self-reliant policy closed the door on the inside. In the process we moved from an externally imposed blockade to self-isolation. We started with our traditional society and, through self-reliance, created an internally circulating economic system. The results were isolation and economic stagnation constrained by limits on domestic resources. Such was the economic development model that prevailed in China for almost 30 years after 1949.<sup>1</sup> Changes came only after the 3d Plenary Session of the 11th CPC Central Committee.

China has never explicitly put forward import substitution or an export-led foreign trade strategy, but judging from what has actually been happening, China has basically been following an import substitution (or industrialization) strategy since the PRC was founded. This strategy has substituted many industrial imports and established a rather comprehensive industrial system whose mainstay was heavy and chemical industries. This strategy played a pivotal role in laying China's economic foundation.

Import substitution is an umbrella term embracing a range of domestically oriented economic policies. In China, import substitution can generally be divided into two stages. Stage 1 took place under the banner of self-reliance before China opened up to the outside world. Import substitution during this stage had the following characteristics: (1) Absence of market mechanisms within the country. There was an excessive reliance on administrative measures and command planning to implement import substitution. A tight lid was kept on imports and domestic demand was curbed. If demand was reined in, less substitution would be needed. A weakened demand was also less stimulating to supply. This method actually did not completely replace imports. (2) Absence of internal market mechanisms. On the one hand, imports were restricted. On the other hand, domestic production had yet to take off. Free from the pressure of international competition, the makers of domestic substitutes developed a kind of inertia and never managed to get a step ahead of the life cycle of the products that were being substituted. This delay necessitated permanent substitution. (3) Imports and exports were not given a chance to stimulate each other. Because substitutes suffered a deferred effect, they were not strong candidates for export. On the other hand, the foreign exchange needed to pay for the import of equipment and raw materials with which to make substitutes could only come from traditional exports. This impeded the improvement of the export mix. The result is that we "exported to import" and found ourselves trapped in a vicious circle. The three characteristics above are closely interrelated. When administrative measures replaced domestic and foreign market competitive mechanisms, and domestic industries were given too much protection, import substitution could take place only at a very low level and continuously squeeze out exports. In the final analysis, import substitution under the banner of self-reliance effectively became the import substitution of a closed economy. The second stage of import substitution took place after the economy was opened up following the 3d Plenary Session of the 11th CPC Central Committee. The open policy injected new life into the entire national economy and foreign economic relations, while also enabling trade to develop rapidly. Large-scale investment coupled with the example of foreign consumption led to an explosive growth in China's import demand. A shortage of foreign exchange became the "bottleneck" in the development of China's foreign economic relations, denoting a widening foreign trade deficit and a drop in the nation's foreign exchange reserves. As a result, the Chinese economy became increasingly dependent on imports. The only way to deal with this situation is import control. Although import substitution is far from ideal as a means of conserving foreign exchange and bringing about product domestication, it eases the foreign exchange shortage in the short run, gives more protection to domestic industries, and stimulates domestic production. Therefore, the strategy of import substitution remained in effect after China opened up to the outside world. The reasons are as follows: First, the change in economic institutions does

not necessarily take place at the same pace as the change in economic mechanisms. Just because an economy is opened to the outside world does not mean that it can instantly change its domestically oriented characteristics. But what can change rapidly is the consumption pattern of domestic consumers, which leads to an imbalance between supply and demand. Since it is impossible to import enough finished products to satisfy the huge consumption demand, we must rely on ourselves and develop domestic production through import substitution. So instead of importing finished products, we import means of production, thereby lowering the level of imports. Second, while China's economic structure is becoming more and more well-rounded, the level of development is still low and the ability to export limited. This puts a severe constraint on the utilization of imported and foreign resources. Import substitution is an appropriate development strategy under these circumstances. Third, it takes time for enterprises and economic entities to change institutionally and ideologically. When the open policy was first introduced and before the shortcomings of "eating from the big rice pot" were eliminated, the overwhelming majority of enterprises were not equipped to enter the international economic cycle. In contrast, the domestic market was large, demand enormous, risks minimal, and profits high. Enterprises had little motivation to orient themselves to the international market. Thus import substitution and concentration on the domestic market presented themselves as a sound strategy with quick payoffs. But import substitution in this kind of open economy is different from import substitution in a closed economy. The former rests on domestic market competitive mechanisms and takes place amid a certain amount of competition. Its aim is more than domestication. It is also to upgrade products and industries technologically.

Yet import substitution in an open economy has failed to end the shortage of foreign exchange in a fundamental way. On the contrary, large-scale imports necessitated by import substitution have resulted in a steady increase in imports. To pay for all these imports, export and the earning of foreign exchange became an important part of the development of foreign economic relations and trade. Apart from taking a variety of concrete measures to increase exports and foreign exchange, China has launched an experiment to introduce an export-led strategy and develop an export-oriented economy in certain areas in the nation that are more open to the outside world and have a relatively solid economic base. Before the open policy was introduced, for instance, exports accounted for some 10 percent of the gross value of industrial and agricultural output of Guangdong Province. By 1986, it had risen to 15 percent. In the same year, exports accounted for just 5 percent of the nation's gross value of industrial and agricultural output. Exports have proved a powerful engine of economic growth in the province. Between 1985 and 1987, the gross value of industrial and agricultural output rose each year—13.5 percent in 1986 and 27.3 percent in 1987. Exports increased 41 percent in 1986 and 28.2 percent in 1987.

Meanwhile, by developing an export-oriented economy, Guangdong has improved its export system, enhanced its capacity to earn foreign exchange, and promoted economic and technical exchanges with the outside world, which all serves in turn to expedite economic growth in the province. One quarter of Guangdong's gross provincial product is realized on the international market, one quarter of its provincial income is derived from overseas sales, and one-quarter of its funds comes from abroad.<sup>2</sup> Facts prove that it is highly promising to adopt the export-led strategy in qualified areas.

## II. Basic Prerequisites for Import Substitution and an Export-Led Strategy

Generally speaking, the following should be the economic policy goals of a nation: economic growth, balance of international payments, effective allocation of resources, full employment, price stability, and income equity. As a policy, import substitution must similarly serve the above objectives.

Long-range economic growth, manifested as industrialization through import substitution, is the top policy objective. An overly restrictive import substitution policy, however, prevents imports from stimulating and nurturing industrialization. Deprived of the stimulus of sufficient expanded investment and of rising labor productivity, industrialization is bound to be slow. In China, import substitution has expedited industrial expansion and overall economic growth, but this does not mean that expanded investment has been sufficiently stimulating or that productivity has been rising fast enough. Between 1965 and 1980, domestic investment in China increased an average of 10.5 percent annually, while gross output value averaged 6.4 percent each year.<sup>3</sup> Corresponding figures for the 1980-1985 period were 16.5 percent and 9.8 percent, respectively. As we all know, China was opening up to the outside world in the latter period and began to free itself from the constraints of domestic resources limitations. To a large extent, imports proved to be a catalyst for industrialization and the result was brisk economic growth.

Some people assume that import substitution, which means replacing imports with Chinese products, can cut down on a great deal of foreign exchange. Many studies, however, show that import substitution does no such thing because it often involves importing foreign equipment and raw materials to carry out domestic production. The resultant increase in imports militates against balancing our international payments. In two different periods, import substitution in China produced the following two diametrically opposite results. Before China was opened to the outside world, import substitution was carried out against the backdrop of a closed economy. We relied completely on our own investment, technology, equipment, and raw materials to produce substitutes. When we imported, we bought only as much as we could afford. We ran no deficit in our international payments. But this kind of import substitution is slow

and does little to spur industrialization. After China opened up to the outside world, import substitution became part of the open economy. We imported large quantities of equipment, technology, raw materials, and intermediate products, even exceeding our ability to pay. In addition, the general import need of various industries and the import of household articles also shot up. On the one hand, we carried out import substitution by continuously importing the needed capital goods. On the other hand, the import of capital goods creates a continuous need for new substitutes, to the detriment of efforts to improve our international payments.

China's import substitution strategy protects domestic industries and helps utilize domestic resources. At the same time, import substitution tends to protect backward industries and naturally lowers the efficiency with which various resources are utilized.

Import substitution is a two-edged weapon when it comes to full employment, price stability, and income equity. I will not go into detail here.

At the heart of the import substitution strategy is the deployment of high exchange rates, high tariffs, and stringent import quotas to hold down imports and protect domestic industries. It is subject to a number of basic conditions: (1) *The internal economic status of the country practicing import substitution.* Normally import substitution is appropriate only for those relatively undeveloped nations at a disadvantage in international trade. When international economic relations become more equal and countries can compete with one another on a level playing field, the protectionist policy of import substitution is no match for an outward-oriented policy that encourages exports. (2) *The characteristics of the domestic capital goods of the country practicing import substitution.* The success of import substitution depends on the following: a rising proportion of the supply of domestic capital goods, increasing domestic investment, introduction of foreign technology and increasing ability to assimilate it, rising enterprise management standards, and rising productivity. In the absence of these improvements, the country will remain dependent on imports. (3) *The economic operating mechanisms of the country practicing import substitution.* Without a sound market mechanism, a highly detailed economic plan is needed to determine how much protection each industry should be given. (4) *The economic policy of the nation practicing import substitution.* Are exchange rates and tariffs appropriately high? Are quotas suitably stringent? Carried to extreme, these policies may prove counterproductive. (5) *The administrative efficiency and national spirit of the nation.*

Among nations of the world, China is still relatively undeveloped with a large number of industries that have yet to catch up with advanced world standards. China is also acutely short of funds and foreign exchange. The import substitution strategy is relevant. On the other hand, China also boasts a number of solid industries that

are well established. To achieve economies of scale and enable them to improve themselves technologically, these industries need competition, not protection. Turning to market mechanisms, China's current market mechanisms are flawed and fail to give sufficient stimulus to industries related to import substitution industries. On the contrary, those industries are so wedded to the benefits of the protectionist policy that they have been scrambling for substitutes. As a result, none have become internationally competitive, the national economy operates in isolation from the world market, and the level of production and product quality continue to trail international standards. We do not depend on market mechanisms, yet our planned management has yet to achieve a high degree of thoroughness. As for economic policy, we still impose high tariffs and rigid import quotas, and follow a high exchange-rate policy. While these policies are quite effective in limiting the quantity of imports, they do nothing to improve the competitiveness of domestic products (especially exports), thereby pushing up production costs, stunting our export drive, and exacerbating the foreign exchange shortage. In the end, our import substitution strategy hurts our effort to better our position in the international economy. For these reasons, the country's current economic conditions are not perfectly suited to such a strategy.

The current trend toward economic globalization and the import substitution strategy has resulted in the increasing dependence of countries practicing import substitution on the world market. Many nations have been shifting toward an export-led strategy. The characteristics of an export-led strategy are as follows: First, this strategy "attacks in order to defend." Countries which follow this strategy promote the export of their flagship products aggressively. They may begin by increasing the extent of processing, then moving onto labor-intensive finished products and later capital-intensive finished products. In the process they earn additional foreign exchange, which could be used to finance the import of technology and equipment for use in strengthening their industrial production capability and enlarging their market shares at home and abroad. Second, the export-led strategy goes hand in hand with trade liberalization. Countries that follow this strategy abolish the rigid and time-consuming import licensing system, lower their exchange rate to a more realistic level, and cut tariffs and supplement them with other measures so as to neutralize the effects of a shrinking domestic market. These countries often take a series of financial and fiscal steps to stimulate exports, such as subsidizing price differences, raising the percentage of foreign exchange that can be retained, and providing inexpensive and convenient infrastructural facilities and services. Fourth, the export-led strategy will draw the nation deeper into international specialization, making it more susceptible to the impact of international economic changes.

The export-led strategy is based on the "two kinds of resources and two markets." It is an active outward-oriented development strategy that seeks to use exports



as the engine of growth for the national economy as a whole. Precisely because of this outward oriented nature, it is under even more severe constraints. (1) Determine which export industries are the nation's strongest and increase their efficiency. Use the earnings from exports to support domestic economic expansion. (2) Strengthen the linkages between export industries and other industries in capital goods and product supply and demand, thereby spreading the stimulating effects of the export industries to other industries. (3) Export industries have a high standard of technology and a strong capacity for absorbing new technology. They adapt readily to the demands of the world market and can function as a transmitter of technology to other industries. (4) The scale of the market transcends national boundaries. But it should not be assumed that the international market is limitless. Both export supply and domestic demand should maintain a degree of elasticity. The exporting country should also take pains to diversify exports and markets to neutralize the uncertainty resulting from changes in the international market. (5) The strength of the export industries derives mainly from domestic resources and overall national economic prowess. Hence the need to improve the technological standard and service capability of other industries. (6) Formulate policies to nurture exports appropriately. Generally speaking, this means dismantling trade barriers to stimulate exports. Exchange rates should be adjusted, tariffs lowered, and export subsidies instituted. Needless to say, the pros and cons before and after adjustment must be weighed against one another. (7) Improve the market mechanism. Make better use of it to rationalize economic behavior through changes in supply and demand, price movements, and distribution of benefits. (8) Promote exports institutionally. Whether it be gathering information, promoting commodities, guiding the flow of funds, coordinating between industries, training personnel, or raising administrative efficiency, institutional guarantee is needed. They should be carried out.

The export-led strategy overcomes many of the weaknesses of import substitution, yet the fact is that its subjection to numerous constraints means that its application in a large country like China is highly regional and multi-level. The coastal region is economically more developed and better able to cope with it. It is also where the nation's advanced industries and sectors are concentrated. Thus the coastal region is the leading player in our export drive and its basic economic development strategy should be the export-led strategy. But this does not mean that China's overall foreign trade strategy is necessarily an export-led one. We must consider the following: (1) In a large country such as China, domestic economic circulation is the primary economic circulation. Imports and exports account for an insignificant share of domestic national product. Our task now is to speed up industrialization to promote foreign trade development. (2) The nation's economic base and operating mechanisms have not developed to such an extent as to make possible the nationwide application of the export-led strategy. The level of our exports is still low.

Domestic industries do not have close ties with one another. Market transmitting mechanisms remain imperfect. There is an urgent need to put together a sound export stimulating system that would include such measures as prices, exchange rates, and taxes. (3) The worldwide economic structural adjustment now under way has both pro and con meanings for us. Most of the industries being spun off by developed nations in the West are less sophisticated and relatively backward "sunset industries." Our objective, however, is more than to increase exports and earn more foreign exchange. We also want to accelerate industrialization. From this perspective, we should go all out to develop advanced industries instead of voluntarily falling into the "trap" created by Western industrial adjustment. Thus we cannot ignore the reality in economic development and make the export-led strategy China's sole foreign trade development strategy.

### III. A New Foreign Trade Development Strategy for China

Both import substitution and the export-led strategy have pros and cons. Both are compatible with China's conditions in some ways, incompatible in others. It seems that the exclusive adoption of either strategy is not our best option in the present circumstances. Judging from the experience of other nations, it makes sense to use any one single strategy only under a specific set of circumstances for a specific length of time. While there have been success stories in the world involving the exclusive adoption of one strategy as a long-term national policy, they did not last long in fact as increasing problems forced a change in strategy. Thus the lesson we should learn is that, as a long-range strategy, we should combine various strategies organically, adopting their good points and avoiding the bad, to form a new comprehensive strategy in which various elements promote each other. Any one single strategy should be applied for only a short period of time and should be replaced as soon as it has achieved its primary purpose. Then there is the regional factor. In a large developing country like ours, the foreign trade strategy should be comprehensive and long-term and accommodate a mix of short-term, single-purpose strategies.

China's foreign trade strategy should combine import substitution with an emphasis on exports. This is not a new idea, but so far no in-depth study has been done, which is what this writer intends to do here.

It is necessary for China to adopt import substitution as well as an export-led strategy because of its dual economic structure in both regional and industrial terms. From this economic dualism arises a need for both import substitution and an outward oriented strategy as demonstrated specifically in the following: (1) The fact that our industries are at different levels of development makes the coexistence of the two strategies imperative. After decades of development, China has produced a number of relatively advanced industries capable or



potentially capable of competing in the world. Examples include apparel, electrical machinery, food, electronics, arts and crafts. They could spearhead our export drive. To be able to continue to develop, it is essential that these industries look beyond the domestic market in such areas as the supply of capital goods, the sale of products, and the dissemination of technology. At the same time, China still has many extremely backward industries with obsolete equipment and a low technological standard. Import substitution helps support these industries and improve their production capacity. It can also speed up their technological transformation. (2) The pattern of our resources and markets also makes it imperative that the two strategies coexist. China is quite rich in resources, but it does relatively little of their processing, which means that some of the domestic need has to be satisfied overseas. Accordingly, we must give a measure of protection to raw material processing industries and reduce imports. On the other hand, there are industries like aircraft manufacturing, aviation, nuclear energy, and instruments and meters that can basically produce enough to satisfy domestic demand. To obtain the benefits of economies of scale, we should orient these industries to the international market and expand exports in order to earn foreign exchange. Here an export-led strategy is more appropriate. (3) Our goal of domestic industrialization determines that the two strategies coexist. Industrialization is still unfinished business in China. To adjust and encourage the rapid growth of certain industries, we must adopt import substitution. But we must also remove protection from those relatively well-developed industries that have grown to a certain size and achieved a certain measure of technical maturity. The mechanisms of international competition should be introduced in these industries so that technological transformation and industrial turnover would come about more effectively. (4) The uneven pace of the open policy requires us to adopt the two strategies at the same time. The different regions of the nation vary in their level of economic development and ability to develop externally. It follows that they should adopt different foreign trade strategies. Given the present situation, it may be a better approach to have the coastal region follow an outward oriented, export-led strategy while the western region and the interior practice import substitution.

Under the overriding goal of speeding up industrialization, we should adopt both import substitution and an export-led strategy to suit the different levels of economic development in different regions. Nevertheless, after a certain period of time, any one single strategy will give rise to problems of one kind or another, which requires corrective action in the opposite direction. To overcome the lack of external competitive pressure and solve such "bottleneck" problems as foreign exchange shortage, we often need to take some measures to encourage exports so that enterprises and products become more internationally competitive and ameliorate our balance of payments difficulties. On the other

hand, the export-led strategy tends to lead to an overdependence on the international market and a lopsided industrial structure. Accordingly, we must adopt some protectionist measures to nurture certain industries, round out the national economic system, and enhance the nation's economic prowess. Hence the need to alternate between the two strategies in the course of developing China's foreign economic relations and trade.

In the opened region along the eastern coast, the export-led strategy must be supplemented by certain import substitution and protectionist measures. Sometimes it may be even more important to protect certain industries and markets than to encourage exports. Industries in the coastal region are more advanced, but only vis-a-vis their counterparts in the interior. Even an industry that enjoys a certain edge internationally may lose its advantage under the pressure of international competition after a period of time. In this case, protection is called for and import substitution should be reintroduced to raise their production capacity, bring about the technological turnover of their products on foreign and domestic markets, and heighten their international competitiveness. In the interior and the western region, import substitution should be combined with a sensitivity to commodity internationalization. Protection should not go on forever. Once they reach a certain level of development, industries hitherto protected should be steered toward the international market promptly. It is international competition that will give these industries the drive for development. When industries become more internationally competitive, it makes it easier to solve our foreign exchange shortage. Regions between the eastern seaboard and the west may put equal emphasis on the two strategies, or they may stress one or the other at different points in time, depending on their own regional economic development level and industrial structure, and shift gears readily in response to changes in the domestic and foreign markets. The fact that these two strategies have differing emphases in different places at different times gives rise to their spatial coexistence and temporal alternation.

The coexistence and alternation of the two strategies necessarily raises questions about the uniformity and stability of China's foreign trade policy. In the past, we often considered it a good thing to impose one unified policy nationwide, ignoring the fact that different regions, industries, and levels of development require different policies. For instance, once we decided in favor of import substitution and cutting imports, we demanded that all industries and sectors be absolutely self-sufficient. This rigid across-the-board way of doing things had done us enormous harm and mentally conditioned us into thinking in a certain way. As a result, there is chaos as soon as we deregulate and over-control as soon as we tighten the leash. In fact, policy uniformity must be tempered with flexibility. As far as foreign trade policy is concerned, uniformity means that we must all open up to the outside world, strengthen international

economic and technical ties, and promote industrialization in China. This is basic to the entire foreign trade policy. But this does not mean that all policy details should be identical across the nation. There should be a regional dimension to China's industrial and foreign trade policy. Coastal areas that are well-developed should emphasize the export-led strategy and develop themselves into outward oriented economic bases with rising industrialization. Some of their growth will trickle down into the central region and then the west, thereby fueling economic development all over the country. To put it differently, the interior should stress industrialization through import substitution and help upgrade industries in the central part by continuously increasing production capacity, thereby supporting the development of an outward oriented economy along the coast.

To bring about the coexistence and alternation of the two strategies, a burning issue is increasing the operational flexibility of China's foreign economic and trade system. Right now the country's level of economic development is low and the economic structure is irrational. When the economy develops rapidly, the "bottlenecks" in the backward sectors worsen. One sign of this is the tendency for imports to increase. Since capital goods account for an overwhelming proportion of our imports, our import demand is highly inelastic. On the other hand, a substantial portion of our exports is made up of primary products with little demand elasticity on the world market. Moreover, China's aggregate demand exceeds its aggregate supply, which means that the production and supply elasticity of our exports is also limited. All this greatly complicates the task of improving our international payments. The solution is still to apply both import substitution and the export-led strategy in turns to increase our imports' demand elasticity and exports' supply elasticity, unifying them at a high level. If we can shift from one to the other in response to changes in domestic and foreign economic conditions, China's economy will develop rapidly at home and abroad.

#### Footnotes

1. Jin Yanshi [6855 1484 4258], "The Stages and Models of Economic Development—A Diversified Description," in *ZHONGQINGNIAN JINGJI LUNTAN*, Issue 3, 1987.

2. Yang Peixin [2799 1014 2450], "On the Great Cycle," in *SHIJIE JINGJI DAOBAO*, 28 March 88.

3. The World Bank, "Report on World Development 1987," pp 204-205.

## ECONOMIC ZONES

### Shantou Continues Developing Export-Oriented Economy

40060502b Beijing GUOJI SHANGBAO in Chinese  
13 Apr 89 p 1

[Article by Wu Bo 0702 3134, chairman of the Shantou Special Economic Zone Board of Directors: "The Shantou Special Economic Zone Is Actively Importing Foreign Capital To Develop an Export-Oriented Economy"]

[Text] The Shantou Special Economic Zone [SEZ] is located in the southeastern suburbs of Shantou, Guangdong, occupies an area of 52.6 sq km, and is divided into the two districts of Longhu and Guangao. In the more than 7 years since it was first founded at the end of 1981, its board of directors has conscientiously carried out China's policy of reform and opening up to the outside world, upheld the principles of being practical and realistic and acting according to its capability, worked hard to scout out a path of low input, high output, and good efficiency while emphasizing the building of its infrastructure, and actively imported foreign capital, improved its links with the rest of China, and gradually established a basic export-oriented economy focused on expanding its productive forces.

The Shantou SEZ has developed a good investment climate through more than 7 years of hard work. It has invested 950 million yuan in capital construction to develop 5.8 sq km. It has built a great deal of infrastructure, such as 43 km of roads, a 3,000- to 5,000-ton dock that can handle both containerized and bulk traffic, 40,000- and 6,400-KVA power substations, a water-supply works that provides 20,000 tons of water a day, and a 3000-series program control telephone system. It has also constructed a number of large industrial buildings, living quarters for staff members and workers, apartment houses for traveling businessmen, hotels, and a multi-storied customs building as well as a building complex composed mainly of large bank and construction buildings, and its production and subsistence facilities are being gradually completed.

Shantou has always been a foreign trade port and a commodity-distribution center for eastern Guangdong, southwestern Fujian, and southern Jiangxi and also a famous hometown of overseas Chinese. It holds an important position in domestic trade and in trade with all counties in Southeast Asia, Hong Kong, and Macao. In developing an export-oriented economy, the Shantou SEZ has emphasized development of its advantages, constantly improved and expanded its domestic and overseas economic contacts, and scored great successes in attracting foreign investment and maintaining its domestic contacts. Until the end of 1988, it had signed 677 contracts to import foreign capital and reached agreements on investments of \$200,930,000, of which \$134,730,000 was to come from foreign investors. It has carried out 355 of these contracts, of which foreign

businessmen have actually invested \$85,960,000. In maintaining its domestic contacts, it has signed 455 contracts and reached agreement on investments of 437,270,000 yuan, of which 412 contracts have been carried out and 313,080,000 yuan has actually been invested.

Importing foreign capital and constantly increasing its investment in capital construction has speeded up the growth of the Shantou SEZ's productive forces while promoting the rapid growth of its foreign trade. The Shantou SEZ has 10 to 20 directly subordinate state-owned companies that have foreign trade management rights that were approved by the Ministry of Foreign Economic Relations and Trade [MOFERT] and the Guangdong Foreign Economic Relations and Trade Commission. Along with increasing its foreign trade with the Hong Kong-Macao and Southeast Asia regions in recent years, the Shantou SEZ has actively developed overseas foreign trade and established direct cooperative trade relations with 24 countries and regions. It has put 201 productive enterprises into operation, of which 178 are industrial enterprises that produce mostly products such as electronics, ceramics, drugs, food, clothing, textiles, machinery, clocks and watches, plastics, shoes, industrial chemicals, toys, handicrafts, leather furnishings, and agricultural and aquatic products, most of which are sold on the international market. The Shantou SEZ had a 7-year gross value of industrial and agricultural output [GVIAO] of 1,120,000 yuan and a gross export value of \$630 million.

The Shantou SEZ's economy grew faster and imported more foreign capital in 1988 than in any previous year. It had a GVIAO of 560 million yuan in 1988, or as much as in the previous 6 years combined, and a gross export value of \$295 million, or 65.7 percent more than in 1987. It imported more foreign capital in 1988 than in the previous 6 years combined. In addition to importing foreign capital from Hong Kong, Macao, and overseas Chinese, it also began to import it directly from countries such as Japan, England, the United States, and Thailand, as well as from the Taiwan area. A long-range investment trend appeared in foreign investment in the Shantou SEZ in 1988, and many foreign businessmen invested more for expanded reproduction or for carrying out trans-industrial operations and competed to buy factory buildings and land to build factories on as soon as the former system of being allowed to only lease factory buildings was changed. For instance, wholly foreign-owned enterprises, such as Jinrong, Huayi, Huadabao, Yesheng, Yixing, Fencheng, and Jinlong, all expanded their factory building areas and production scope by 1- to more than 7-fold. A good trend also appeared in the use of foreign capital for land development in the Shantou SEZ. The Shantou SEZ signed 5 contracts and letters of intent with foreign businessmen in 1988 for cooperative land development or paid land transfer, and reached agreements to import 92,130,000 yuan of foreign capital to develop 510 mu of land. Construction has recently begun on some of these projects.

Encouraging progress has also been made since 1988 in negotiations to import foreign capital to set up a petrochemical project in the Guangao District. The Thailand Zhenda Group came to the Shantou SEZ to investigate and hold talks in 1988, and their application to set up a 250,000-ton ethylene project in the Shantou SEZ's Guangao Bay was recently approved by the Guangdong Provincial People's Government. The Thailand Zhengda Group has set up in the Shantou SEZ a preliminary agency of the Shantou Guocheng Petrochemical Co, Ltd to begin preparations for building this petrochemical project.

Most of the 168 solely-owned, cooperative, and joint venture enterprises in the Shantou SEZ have now achieved good economic efficiency, which has generally increased the investment confidence of foreign businessmen. The Shantou SEZ has a large, clever, and well-qualified workforce, technicians in all fields, and a definite capacity to absorb more foreign capital and import more advanced technology to develop its export-oriented economy.

China is now concentrating its efforts on controlling our economic climate and restoring order to our economy in order to build our economy more successfully. But our general policy of reform and opening up to the outside world will not change and the state is firmly carrying out our coastal economic development strategy and taking policy steps to leave one side of our net open. As the first level of China's opening up to the outside world and an SEZ for importing foreign capital to develop an export-oriented economy, the Shantou SEZ will, just as in the past, continue to carry out the policy of reform and opening up to the outside world by wholeheartedly welcoming and encouraging foreign businessmen—our Taiwan compatriots in particular—to come to Shantou to invest, set up enterprises, carry out land development, and engage in all kinds of foreign economic relations and trade cooperation.

In order to make it easier for foreign businessmen to come to the Shantou SEZ to hold investment talks, we have set up a foreign capital import office, are gradually drawing up more favorable policy measures, and are striving to provide all kinds of services to foreign investors. We will also continue to improve our investment climate, build a better SEZ infrastructure, actively lay the groundwork to attract people from all circles both in China and abroad to come to the Shantou SEZ to invest and carry out cooperative exchanges in all fields, launch all kinds of foreign economic relations and trade activities, and promote a new phase in the development of our export-oriented economy.

## LABOR

### Enterprise Wage Reform

HK2606101589 Beijing JINGJI GUANLI in Chinese  
No 3, 1989 pp 44-46

[Article by He Tianzhong (6320 1131 0022), edited by Lin Daojun (2651 6670 0689): "Several Views on Wage Reform in Enterprises"]

[Text] At present, people still have no uniform ideas about how to resolve the supply-demand contradiction

and the problem of inflation. Many comrades have decades of rich experiences in suppressing demand, but no abilities in increasing supply. This is manifested in wage distribution whereby, under serious conditions of inflation, a basic freeze on growth in real wages and reducing the real income levels of millions of staff members and workers has been seen as a normal and justifiable solution to the problem. In terms of resolving the supply-demand contradiction and the problem of inflation, this wage distribution policy is not an effective measure for dealing with the situation; rather it is, in effect, drinking poison to quench the thirst. It runs counter to the improvement of the contract system and, in terms of motivating the enthusiasm of the staff and workers, it is a measure which goes against the trend.

### 1. On the Covert Wage Reform Reversal

At present, many people are good at raising the banner of the central authorities and extracting paragraphs or sentences from the central documents to promote their own road. I can state with some certainty that the main arguments for the covert reform reversal [gai ge fu gui 2395 7245 1788 2981] in wage reform at present are: (a) There is an insufficient understanding of the serious results of freezing real wages and reducing the real incomes of some staff and workers. The rational proportional relationship between production and real wages which had been maintained since the 3d Plenary Session of the 11th CPC Central Committee has been abandoned, the longstanding practice of actual-wage freezes has been revived, the promises and plans of the party and government have been forgotten, criticism that current wage growth has been excessive, and that control has been lost. For example, the Seventh 5-Year Plan stipulated that national income would grow 7 percent each year, while real wages would increase 4 percent each year. In the government work report of the Seventh NPC, it was declared that "we must strive to ensure that, during the period of the Seventh 5-Year Plan, the average level of real consumption by the urban and rural residents of the entire country will rise by an average of 4 percent annually." The actual situation was that, in 1987, national income grew 9.3 percent (in excess of the 7 percent), and the labor productivity of all industrial workers grew 7.6 percent (the plan stipulated 4 percent). However, the average level of real wages grew less than 1 percent, the real income of urban residents grew only 1.7 percent, and in 21 percent of urban households the level of real income dropped. In 1988, it is estimated that GNP grew 12 percent on the previous year, national income increased 10 percent, and the growth in labor productivity of overall industrial workers was close to two digits. From January to September, the average annual money wage of staff and workers was 1145 yuan, a 16.8 percent growth on the same period in the preceding year. In the same period, retail prices rose 16 percent and livelihood consumption by staff members and workers in the 32 large and medium-size cities in which they are centralized rose 18.3 percent. That is to say, average

real wages fell by about two percentage points. In October, the total volume of the money wages of staff and workers grew 29.3 percent, while the consumer price index for staff and workers in the 32 cities grew 31 percent in the same period of the previous year. In some cities the latter figure was close to 50 percent and the average real wages of staff and workers continued to decline. In addition, due to price rises, out of 530 billion yuan of surplus purchasing power for urban and rural people, nearly 80 billion yuan has been lost due to depreciation—an average of about 80 yuan per person. In response to this situation, the comrades of some departments have not satisfactorily explained the situation to the masses or sought forgiveness. Instead they have repeatedly placed blame on the growth of consumer inflation and claimed that the growth of consumption funds has been excessive. Actually, the state has repeatedly and clearly noted that, within the scope of the total amount of wages, the enterprises can decide on distribution by themselves. For 3 years, the government has not arranged for enterprises to readjust wages or to implement normal increments. Some areas even restricted floating wage increments. From January to October 1988, the growth in bonuses over the previous year was close to 8 billion yuan. If these bonuses had not been issued, average real wages would have further declined by approximately 4 percent.

With such a situation, how can it be guaranteed that the level of real wages of the majority of staff and workers will not decline, and be other than an empty statement? (b) On the financial level, there has never been a real recognition of the contract system. When the contract system was first introduced, it was declared that the regions would be financially responsible for the institution of the reforms and that the financial relationship between the central authorities and the local authorities would continue to be handled in accordance with the system set down for the second step of the reform by which tax payment would replace profit delivery. The additional profits retained by enterprises and the increased income of staff and workers subsequent to the implementation of the contract system were to be the burden of the local financial administrations. Further, if enterprises did not complete their contracts, compensation was payable from the risk-security funds of the enterprise operators, staff, and workers. The contract of the state financial administration with the enterprises was actually one whereby it took their profits but did not have to worry about their losses. Its only worry was that enterprises and staff and workers might have too much and distribute too much, and was not concerned whether or not real wage levels fell. In terms of macroeconomic management of wage distribution, it did not take the initiative in coordinating with enterprise contracts, and instead frequently established obstacles. Now, 95 percent of large and medium-size enterprises in our country have implemented the contract system. However, by the end of 1987, the number of enterprises which had been approved by relevant central departments to have the total amount of wages linked with enterprise economic

results, was only 3352, with a total number of staff and workers of 14.19 million. This was just 26.4 percent of the total number of large and medium-size enterprises and only 38.5 percent of their total number of staff and workers. About 5000 enterprises were approved by localities to link total wages with enterprise results, but these have not been officially recognized by relevant state departments. Today there are still many contracted enterprises where the contract specifies only rights and interests relationships of the contracting operators and does not touch on the income distribution for the whole body of staff and workers. Last year it was further stipulated that in future, when there is linkage of wages and economic results, the bonus component will be expended from the profits retained by the enterprise in accordance with the practice by which payment of tax is replacing delivery of profits. It was no longer permitted to include this component in costs. This essentially returns the linkage of total wages and the enterprise's economic results to the original practice of the second step by which payment of tax replaces profit delivery. Further, although linkage of basic wages is allowed and they can be included in costs, the increase in basic wages is generally controlled directly by the state, decreasing enterprises' power to make their own decisions. The readjustment of wage standards, formal increments and the implementation of subsidies are all subject to restrictions. Thus, as the bonuses are linked with economic results, but cannot be included in costs, this actually results in the reduction of the wage increase ratios of the linked enterprises and the squeezing of production development funds. Further, the great increase in the prices of raw and semi-finished materials have already seriously affected the growth in enterprise profits and taxes. On the basis of the 1 : 0.7 ratio set down in 1985, it is already difficult to guarantee the real wage levels of staff and workers. For example, from January to October 1988, the realized profits and taxes of industrial enterprises within the budget throughout the country grew 16.8 percent over the previous year. Using the 1 : 0.7 ratio, the money wages of enterprise staff and workers could only grow 11.8 percent, far below the growth in prices. In a situation where there is a regulatory tax on wages and where the consumer price index for staff and workers has risen over 18 percent, allowing only about half a month's bonus (60 yuan) before the tax levy kick-in point, is the same as changing the original wage regulatory tax kick-in point of 7 percent to about 11 percent. This year there is a need to hold down the speed of economic development and keep production growth to about 10 percent. According to the existing linkage ratio, the total amount of money wages will be held at a 7 percent increase. Even if there is a further relaxation of half a month's bonus before the regulatory tax kicks in, this will not have much significance for the majority of enterprises. (c) Although the serious implementation of distribution in accordance with work is stressed in policy statements, in actual actions it is often the case that from top to bottom there is "a big pot", which intensifies egalitarianism. In 1985, when organ and institutional units changed the structural wage system and unified

wage standards, there were widespread increases in increments, while wages rose close to 20 percent. It is said that the orientation of the reform was correct and the implementation was smooth. However, it was very difficult to see any effect the reform had on motivating enthusiasm or raising work efficiency. In that year organs first unified wage standards and approved general increments for organs and then the enterprises on a self-funded basis, and turned their bonuses into fixed wages and salary level increases. Although this practice alleviated the wage distribution contradiction between organs and enterprises, it affected the enthusiasm of staff and workers and gave production a pounding. If we continue to repeat the past with many of the same practices when improving the economic environment, we will have to pay an even higher price.

## **2. We Need to Establish a New Socialist Distribution Theory Standpoint**

The direct causes of the problems which have appeared in wage distribution are the burgeoning supply-demand contradiction and inflation. However, the main root and a long-term factor of the problem has been the defects and deficiencies in the traditional socialist distribution theory. Thus, the way to resolve the problem is to establish a new standpoint on the theoretical level, and draw reform onto a new track.

Total demand exceeding total supply is the common illness of several socialist states. Shortage economics [duan que jing ji xue 4252 4972 4842 3444 1331] was not created by China, but we have not yet passed through this difficulty. It can be said that since the founding of the PRC, we have never had a situation of surplus supply and insufficient demand. Now, it is just that the problem is more prominent and more intense. The factors giving rise to this situation are inseparable from the defects of the traditional Marxist distribution theory. Marx put forward the principle of distribution according to work through the exchange of equitable labor. This was his great theoretical contribution. However, he restricted distribution according to work just to individual means of consumption and held that socialist distribution is only "the distribution of means of consumption between the various producers." He excluded all laborers from direct participation in investment activities for expanding social reproduction and increasing accumulation. In this way people could only obtain their individual means of consumption, including food, clothing and utensils through labor, and the need for food, clothing and utensils spurred people to give play to their laboring capacity. That is, for their entire lives, people have to engage in individual economic activities within the narrow confines of livelihood consumption, their income will always be consumption funds and can never be rationally transformed.

In the 26 years from 1952 to 1978, our country's national income grew 5.1 times, the labor productivity of the entirety of industrial staff and workers grew 1.66 times,

while the average real wages of staff and workers grew only 15.2 percent, an annual increase of 0.3 percent. This was far lower than in Japan and FRG which had quite high original base levels. And yet, we still did not experience a situation of supply exceeding demand. In the last 10 years, the growth in real wages has not exceeded the gross value of industrial and agricultural output or the growth in GNP, and yet society was unable to bear this growth. Now, when we are discussing demand being greater than supply and the situation of inflation, it needs to be pointed out that the surplus purchasing power of urban and rural residents is 530 billion yuan, while stored commodities total only 253.3 billion yuan. That is, there is only 0.50 yuan of stored commodities for every yuan of surplus purchasing power. Any panic purchasing will set off tidal waves. If we remain stuck in the old theory in such a situation, when maintaining the real wage levels of staff and workers is difficult, how will we be able to raise them? However, with 530 billion yuan of surplus purchasing power, this is only 400-500 yuan per person. If some people's minds were not fettered by some traditional concepts, how could they have adopted the practice of basically freezing the real level of wages of staff and workers, and forgotten that this would harm their enthusiasm and even produce a pernicious cycle in economic development?

At present, the prime issue is to clarify, on the theoretical level, the following points: Socialist distribution is the distribution and redistribution of the overall GNP and national income, and is not only restricted to the distribution of individual means of consumption between laborers; individual income can be used in livelihood consumption or can be transferred to the production sphere. The party's 13th Congress and the various plenary sessions since then have mentioned the question of non-labor income, the question of the privatization of housing and the sale of shares and bonds to the society, and the question of the transfer of consumption funds. This has been a major breakthrough in terms of traditional socialist distribution theory and its significance is extremely deep-going. In fact, under commodity economy conditions, any state, society or person, regardless of whether they have means of production or means of consumption, can increase the standard of living and increase individual wealth, and production funds and consumption funds can be mutually transferrable. Forcibly restricting the income of laborers within the scope of clothing, food and entertainment is a foolish action that is self-injurious.

### 3. The Road for Reforming the Wage Distribution System in Enterprises

Resolving the drawbacks of the socialist distribution theory and breaking down the ossified ideas of those who refuse to make progress will allow the deep-going reform of the enterprise wage distribution system. Under the preconditions of adopting the appropriate measures and

maintaining and increasing individual savings, and especially under the precondition of some consumption funds being transformed into production funds, we can consider: (a) Doing away with the policy of freezing wages and, within the limits which the state and society can bear, appropriately raising the real income levels of staff and workers. This should not be an act of grace from above. Rather, the enterprises, staff, and workers should be allowed to make money to improve their own lives. The Seventh 5-Year Plan stipulates that national income will rise 7 percent and that average real wages will rise 4 percent. Not only will this not be hazardous, but it will be of benefit to both the state and the people. We should not submissively surrender this requirement. (b) We should no longer have unified wage standards, unified arrangement of increments, and unified enterprise wage structures. The state's control of enterprise wages should only be exercised through the linkage of the amount of total wages and enterprise economic results and the setting down of a ratio between results and wage rises. At present, the linkage ratio should be raised from 1 : 0.7 to where both figures grow at the same rate, and there should no longer be an averaged distribution of price subsidies. The kick-in point for the wage regulatory tax should be set at a figure above the sum of what is required to maintain the existing real wage level (equivalent to the staff and workers consumer price rise index) and the state-planned increase in wage levels. (c) While taking measures to stabilize and increase savings, not only must we guide accumulated consumption funds into becoming production funds, but must also find ways to ensure that newly-increased consumption funds are also transferred into this area. The privatization of housing and allowing fruitful enterprises to collect funds in society are both feasible measures. The problem is that, in the past, wages did not include an amount for purchasing housing and the vast majority of people do not have this purchasing power. Their capacity for purchasing shares and bonds are also very limited. We might consider, when increases in money wages have maintained the original real wages, to issue an appropriate number of house-purchase fund bonds. Also, through adopting the appropriate forms, it will be possible to ensure that the staff and workers are able to share some of the benefits of their enterprise's increased accumulation of funds.

### PRC MEDIA ON FOREIGN ECONOMIES

#### Japan 'Model' for Development of Enterprise Groups

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[Article by Liu Xiaoyan 0491 2556 1750, China People's University and Liu Qian 0491 3602, Ministry of Coal Industry Cadre Management Institute: "Thinking About Development of China's Enterprise Groups—Inspiration From Study of Japan's Enterprise Groups"]

[Text] Japan's enterprise groups already have a history of several decades and have had an enormous influence on

Japan's national economy. Study and discussion of the development and present situation of Japan's enterprise groups is of very great theoretical and practical significance for the development of China's enterprise groups.

### Several Observations Concerning Japan's Enterprise Groups

#### 1. *Background of the Development of Japan's Enterprise Groups*

After the war, Japan implemented a series of major reforms, one of which was the dissolution of the old zaibatsu [financial clique] system which had served as the economic base of Japanese militarism. However, with changes in the political and economic environment and the lack of thoroughness of the measures, the old zaibatsu capital built up again after a few years and, after reorganization based on Japan's three major prewar zaibatsu, appeared in the new form of monopoly capital, and is therefore known as "old zaibatsu system enterprise groups," including the Mitsubishi, Mitsui, and Sumitomo groups. In order to contend with these, second- and third-class pre-war zaibatsu, as well as a number of zaibatsu-tinged weak enterprises centered around large banks, also formed enterprise groups after the war, and were known as "new enterprise groups," including the Fuyo, Daiichi Kangyo Bank, and Sanwa Groups. These two large sets of groups became Japan's six major financial groups.

The mid-1950's were the initial stage of Japan's high-speed economic growth, and heavy and chemical industries occupied the leading position in its industrial structure. Not only was there high-speed growth of capital investment, there was also rapid development of heavy and chemical industries, centered around such products as steel, chemicals, shipbuilding, and machinery. Naturally, development of enterprises characterized by heavy industry capital was also remarkable. They began to break away from the monopolistic groups to which they had originally belonged and manifested an enormous trend toward independence. In addition, they not only grew larger day by day themselves, but also widely established a vast number of subsidiaries and affiliated companies, thereby making it possible to establish the position of independent enterprise groups. These included major companies with abundant technological strength, such as Nippon Steel, Matsushita, Toyota, Toshiba, Hitachi, and Nissan.

It is not difficult to see that the above three types of enterprise groups have different characteristics due to their different development backgrounds. Of these three groups, the first two types of enterprise groups have preserved a strong financial tinge, and are concern-type financial monopoly capital, while the independent enterprise groups are industrial trusts which are intercombined with respect to technology and production, with specific heavy industry capital and specific huge companies at the top.

### The Present Situation of Japan's Enterprise Groups

#### *Indicators of Japan's Enterprise Groups*

The so-called group indicators can be regarded as the basic factors in forming enterprise groups and maintaining them as whole entities. In Japan, the following are generally viewed as the indicators of enterprise group combination: (a) establishment of a board of managers; (b) taking charge of shares; (c) sending each other high-level staff members; (d) series loans; (e) transactions within groups; (f) expansion of the whole group toward new fields of undertakings; (g) joint management of trademarks and display of markings and symbols; (h) the existence of general trading companies.<sup>1</sup>

It can be seen that the above reflect still more the characteristics of financial system enterprise groups; this is related, of course, to the view that only financial groups are typical enterprise groups. However, we can by no means ignore the basic attributes possessed by independent enterprise groups as enterprise groups; moreover, what is even more important is that independent enterprise groups are displaying the future direction of development of enterprise groups, including financial enterprise groups.<sup>2</sup> Precisely for this reason, it is necessary to include the existing characteristics of independent system enterprise groups among the group indicators.

Compared with financial enterprise groups, independent enterprise groups have many different characteristics. First, they are serial companies which command by using enormous amounts of industrial capital; second, they by no means depend on specific capital or "series loans" by leading banks; third, they by no means exercise control entirely through capital, as cooperation in production technology is also one of their methods of control; and fourth, their scope of operations is often concentrated on a specific industry or industries related to them. Therefore, in considering the indicators of enterprise groups, one must also consider the existing characteristics of independent enterprise groups; only group indicators which include the characteristics of financial enterprise groups and independent enterprise groups can be regarded as the group indicators of general enterprise groups.

### The Structure of Japan's Enterprise Groups

If one were to simply sum up the structural state of Japan's enterprise groups, one could say that financial groups display a "state of diversified combination" while independent groups display a "state of pyramidal arrangement." The former are centered on banks and their core circle is composed of banks, trading companies, and large central enterprises, and through their ring-shaped mutual shareholding form a diversified combination. At the same time, the enterprises in this series which are outside of this core circle are also combined in a separate series around a central bank (or



enterprise). The antennae of financial groups extend to production, distribution, and various areas of finance, and could even be said to have deployed their own enterprises in every field of industry. Independent groups, with specific huge companies at the top, control a vast number of subsidiaries and affiliated companies, and through them absorb a network of cooperative relations consisting of a large number of medium- and small-sized enterprises, forming a pyramidal, vertically-arranged enterprise group structure.

### **The Organizational Form of Japan's Enterprise Groups**

Financial enterprise groups have no specific center of authority; the central enterprises have no relationship of direct control with respect to other enterprises, and group affairs are handled and resolved through consultations by the board of managers. The board of managers consists of the various member managers; it is the group's highest organizational structure, and uses a centralized leadership system. Since enterprises within the group mutually hold shares, the board of managers can be regarded as a special form of assembly by the general meeting of shareholders.

Independent enterprise groups, through having core enterprises with extremely great autonomy adopt the form of vertical control and organize the production and operations activities of subordinate enterprises, have thereby established a powerful leadership system. The group's highest organizational leading body is the board of directors which, through its subordinate standing committee, manages the group's business. Independent groups mainly implement operational systems of unified business accounting and management of different levels, or business accounting at different levels and management at different levels. The Nippon Steel and Matsushita Groups may be said to be typical examples of these two operational systems.

### **The Internal Relations Principle and Operational Principle of Japan's Enterprise Groups**

Bringing overall effects into play depends on establishing relationships of dependence, trust, cooperation, and restraint among the enterprises within the group. Independent enterprise groups have a fairly clear view with respect to the principle of enterprise relations. They maintain norms for core enterprises and subordinate companies with respect to responsibility, rights and interests, and obligations. They stress that core enterprises and affiliated companies, as members of the group, should coexist, flourish together, and be coordinated with one another. The managers of the affiliated companies bear full responsibility for their own companies' autonomous operation, while core enterprises maintain close relations with affiliated companies only from the standpoint of stockholders, in order to strive for overall benefits, but do not bear responsibility for management. However, the operational divisions of core companies have responsibility for managing affiliated

companies with respect to operational relations, and problems which emerge between affiliated companies are dealt with by core enterprises.

In order to adapt to competition, strengthen control, and seek group benefits, Japan's enterprise groups have also formed a complete set of operational principles. In fact, the groups' principle of relations is itself one part of the operational principle. They believe that the various enterprises within the group should mutually supplement and flexibly utilize each other's technological strength and other resources; the head company should make the final decision on adjustment of the group's scope of operations and internal disputes; transactions within the group should be based on contracts, in accordance with reasonable prices (with market price as the standard) and thorough planning; core companies generally adopt the direction of decentralization of power with respect to subsidiary companies, even stressing the operational formula of "control of capital and freedom of work," and allowing subordinate enterprises ample operational autonomy, not only bearing responsibility for profits, but also independently and freely bearing responsibility for management of such areas as production and marketing, talented personnel, and capital investment. They have increased both operational efficiency and competitive strength.

### **Several Key Issues Related to the Development of Japan's Enterprise Groups**

#### *1. Enterprise Groups and Financial Intervention*

Because Japan's enterprise groups have differing development backgrounds, their relations with financial institutions are not entirely alike, either. In the history of the development of financial groups, since enterprises' own funds were insufficient and stocks and bonds markets were by no means developed, enterprises had to rely on loans from financial institutions for the overwhelming majority of their required funds, and thus the influence of banks on enterprises has been constantly strengthened, and banks have directly supplanted the central position of groups. Therefore, we can say that a financial enterprise group relies on specific banks to provide serial loans to its enterprises and implement so-called "loan operations," thereby forming a strong financial tinge. The financial strength of the independent enterprise groups which have grown up after the war is relatively abundant, and the enterprises' own funds account for a larger percentage; therefore, their operational activities rely mainly on their own funds, and "non-loan operations" are regarded as the objective of the struggle. Even when ties to financial institutions do occur, the groups by no means rely on serial loans from principal banks, but rather form multiple channels of capital-raising sources, including widespread use of government financial institutions, long-term credit banks, city banks, and foreign capital, thus maintaining their independence from financial institutions.

## 2. Enterprise Groups and the Shareholding System

Japan's enterprise groups generally make stock companies their most basic form. Mutual holding of stocks has become the most basic method of strengthening group unity. There are various forms of shareholding. There is both mutual shareholding among the group's core enterprises and mutual shareholding between banks and enterprises, as well as core enterprises' holding shares of subsidiary firms and affiliated firms. The shareholding of financial enterprises assumes the form of a ring; in recent years, there has been a notable increase in the shareholding rate of core enterprises within the group, while in the shareholding of independent enterprise groups, almost every major bank has become a major shareholder. However, they pay more attention to avoiding the occurrence of shareholding and loan relations with the same bank at the same time. In addition, unilateral shareholding by parent companies of subsidiaries has also formed a vertical relationship of rigid control. Usually, companies whose shareholding rate is over 50 percent are called subsidiaries, while companies whose shareholding rate is over 10 or 20 percent but under 50 percent are called affiliated companies. The most important means by which parent companies control subsidiaries and affiliated companies, in addition to technical guidance and assistance, sending cadres, establishing coordinated organizations, and strengthening cooperation, is capital participation and shareholding.

## 3. The Function and Impetus of Government

The development of Japan's enterprise groups has from beginning to end received policy and economic support and assistance from the Japanese government. First, it has provided legal guarantees. The Japanese government has revised the "Antimonopoly Law" several times in succession, loosening restrictions with regard to such things as mutual shareholding among competing companies and holding of concurrent high-level posts. It has encouraged mutual shareholding and merger among enterprises, thereby completing the legal process from "prohibition of monopoly" to "restriction of monopoly," creating conditions favorable to the rapid movement of enterprises toward enterprise groups. Second, there is a clear industrial policy. Japan has consistently pursued the principle of "upgrading the industrial structure." This so-called "upgrading" has had different meanings at different times. Prior to the 1970's, upgrading the industrial structure was primarily increasing the proportion of heavy and chemical industries within the industrial structure, while after the 1970's it has meant increasing the proportion of knowledge-intensive industries. As a result, this has not only the most advanced productive strength and scientific and technological level of the time, it has also guided enterprise groups in grasping at the right time the direction of operational development of enterprises amid fluctuations in the industrial structure, thereby enabling them to establish themselves in an unassailable position, as well as providing impetus for the stable but rapid development of

Japan's economy. Third, the government has provided guidance in a planned way, as well as adopting a complete set of measures in financial and monetary areas. At Japan's different stages of economic development, the Japanese government, in accordance with the circumstances of the time, has adopted various preferential policies and measures to support the development of enterprise groups. For example, in order to encourage merger among enterprises, the government formulated a "new economic and social development plan"; by formulating a "special depreciation system," it reduced the tax burden of enterprises; and through such means as budget allocations, it has provided enterprise groups with funds for expanding reproduction. The Japanese government has also adopted measures to push enterprises with competitive strength forward into the international market, and enable Japanese enterprise groups to establish an international position.

## A Comparison of Chinese, Japanese Enterprise Groups

### 1. The Present State of Chinese Enterprise Groups

Originally, most of the alliances between members of China's enterprise groups began as alliances in production. As the alliances developed, they made a gradual transition to alliances in operation. Currently, enterprise groups formed with large key enterprises with well-known products as their core, cooperation in production, technology, and operation as their basis, and economic contracts as their link account for the majority of enterprise groups formed. In essence, these enterprise groups are primarily manifested as voluntary combinations of operational rights; there are still few enterprise groups in the typical sense which make working assets their means of combination, and these are still basically at the exploratory stage. In addition, shackles with respect to policy and the system which were brought by the old system have also undoubtedly enormously restricted the healthy development of enterprise groups. It may be held that since both the internal and external situations are imperfect, China's current enterprise groups are still in an immature state.

### 2. The Individual Character of China's Enterprise Groups

China's unique historical background and economic and social environment have inevitably left an indelible mark on enterprise groups, which are themselves the product of the commodity economy. A clear understanding of this point is very important to the smooth development of enterprise groups.

First, factors in the system. China has implemented a socialist economy based on public ownership in which many kinds of economic elements coexist, and this has complicated rational flow of factors of production within enterprise groups. This is because differences in ownership rights inevitably affect the economic properties of

enterprises. Even in the case of the conversion of group property to shares, who will serve as the agent of state-owned assets is still a problem which must be solved.

Second, the effect of overlapping between new and old systems. The principle of "three no changes" which developed from the old system still constricts the further progress of enterprise groups, and the enterprise group planning units which were formulated to break down the barriers between upper and lower levels and between different departments or regions is not the best policy, either; these can exist only as a transitional measure. New economic reform policies constantly emerge which are often not completely perfect and from which interference by the old system often cannot be excluded, and this situation often places the development of enterprise groups amid various contradictions. Perhaps the so-called "secondary legal entity structure" of enterprise groups is the best example of this.

Third, the imperfect market environment. China's commodity economy is still very undeveloped, and the role of the market mechanism is still difficult to adequately bring into play. Therefore, it is difficult to rely on the market mechanism to restrain and encourage the development of enterprise groups. Actually, only a perfect market environment can promote the rapid but rational development of enterprise groups.

The above aspects have determined that China's enterprise groups, in addition to having ordinary general characteristics, also have additional "characteristics" endowed by their "Chinese flavor," and we cannot avoid this.

### *3. Analysis of the General Characteristics of Chinese, Japanese Enterprise Groups*

The development of the commodity economy and the increasing centralization of production has to a certain degree inevitably brought an intermixing of production capital with circulating capital such as financial and commercial capital, thereby further expanding competitive strength. This has resulted in a movement from production combination by the contract method to capital combination, thereby producing a new method of production organization; this indicates that the group system is tending toward maturity. Japan's enterprise groups have already completed this process. In China, however, since the commodity economy started comparatively late, enterprise groups, too, are still in the initial stage of development. However, as the products of the commodity economy and large-scale socialized production, they also inevitably have properties and jointly followed economic laws endowed by the commodity economy, and therefore the means and methods adopted may be identical or similar; this is our starting point in understanding the lessons drawn from the experience of development under different systems. This is the first characteristic.

Enterprise groups are a form of production organization which have developed in the commodity economy and adapted to the needs of market competition, and their special characteristics or, precisely speaking, the special characteristics of groups, must have a great deal of consistency. First, group members want to obtain an overall effect, i.e., overall coordination, through transregional, transindustrial, and transdepartmental combination, and through flow and cooperation in areas such as technology, production, resources, talented personnel, and markets. Second, enterprise groups, in order to adapt to the rapidly-changing demands of competition, reduce risk, and obtain larger profits, generally have many functions, combining production, scientific research, development, marketing, services, and even finances, and implementing diversified operation. It may be stated that wholeness and multifunctionality have already become basic symbols of Japan's enterprise groups, and that China's enterprise groups will also endeavor to pursue them. This is the second characteristic.

Once enterprise groups are formed, they must formulate and form a series of group standards, relationship principles, and operational principles. Japan's enterprise groups, through several decades of trial and error, have already formed a complete set of group standards and have mature operational measures and management methods; we have already touched on this in the foregoing introduction. I believe that there is no essential distinction between Chinese and Japanese enterprise groups in these respects, and it is entirely possible for China's enterprise groups to refer to, and draw lessons from, Japan's experience of success. This is the third characteristic.

The composition of Japan's enterprise groups generally has capital combination and mutual share participation as its links. With respect to management, Japan's enterprise groups generally put into practice a unified principle of centralized and decentralized authority and implement a manager responsibility system and board of managers system under a board of directors. In the case of China's enterprise groups, however, not only is their leadership system immature, the principle of centralized and decentralized authority has not really been understood and put into practice, either, and the medium of the composition of enterprise groups is still largely the use of well-known products as the leading products and large mainstay enterprises as the core. It is therefore very difficult to call these enterprise groups in the true sense of the word, which inevitably results in a lack of centripetal force in pursuing the interests of the whole. Naturally, this problem has already come to be understood by people, and there is a trend toward making the shareholding system the basis for forming enterprise groups. In this respect, I believe, the share system structure of Japan's enterprise groups is not only an orientation, it also plays a very important role as an example. This is the fourth characteristic.

Naturally, Japan's enterprise groups were basically formed after the war; they both have their original development base and were also aided by the international and domestic environment of that time, and promotion by the government has also played a fairly important role. It is especially important that capitalism has gone through several centuries of development, market mechanism industries have been formed, and enterprises have a favorable external environment; this has in turn stimulated enterprises to form a perfect internal motive force mechanism, and this has become a condition for the development of enterprise groups. The development of China's enterprise groups, however, is "congenitally deficient," and we not only face many problems, but also lack sufficient experience; therefore, we must study the background of the growth of foreign enterprise groups in order to open our field of vision and thinking, as well to choose what is best for our use.

### Thinking Deeply After Comparison

I believe that the investigation and comparison of the enterprise groups of China and Japan not only provide us with enormous inspiration, also allow us to obtain enlightenment and enables us to have a clear train of thought regarding the development of China's enterprise groups.

*1. Attaching importance to the historical role of enterprise groups and grasping opportunities to spur the development of China's economy.* Japan's enterprise groups, as a new form of capital organization which appeared at the stage of monopoly, occupies a very important position in Japan's economy. Japan's independent enterprise groups in particular developed during Japan's postwar period of rapid economic growth, using their unique market behavior and "ability to adapt to the environment based on technical monopoly" to surpass Japan's other zaibatsu groups, and they have played an important role in upgrading Japan's industrial structure. Now, China is facing a crucial period of economic system reform and economic takeoff, and enterprise groups should also play an enormous role in the development of China's economy. Their development cannot only solve the problems of disposition of resources and motive force mechanism, creating conditions favorable for the establishment of a new economic movement mechanism, it can also change the concrete form of enterprises under the traditional system. Enterprise groups also have an unshirkable responsibility in such areas as economic structural adjustment and internationalization of enterprises. In this sense, I believe, Japan's independent enterprise groups have even greater importance for us as a reference. As for monopoly brought by the development of enterprise groups, it is unavoidable, and all we can do is to limit it through policies and law.

*2. We must carry out a policy of rationalization and upgrading of industrial structure and give enterprise groups a correct orientation.* Japan's experience in this area is worth using as a reference. The main task of

Japan's Ministry of International Trade and Industry [MITI] is to "put forward an effective tentative plan as a policy objective and apply adequate persuasion to win over people in industry and lead them to this tentative plan."<sup>3</sup> In order to realize this basic aim, the Japanese government has also formulated many preferential policies, with the result that it has given enormous impetus to economic development. China has been in a state of "stagnation" all along, and the traditional system and traditional concepts are naturally one of the causes of this, but the lack of a clear industrial policy orientation is also a major cause. Therefore, concerned departments must revise industrial policies in a timely manner and propose to industry a prioritized order for economic development. There must also be specialized government departments to plan and formulate industrial policy, apply persuasion, and guide the industrial direction of enterprises (especially enterprise groups), as well as supervise and promote the implementation by enterprises of the state's economic policy. In order to put the government's industrial policy into a concrete form, the government must also give support in such areas as capital, raw materials, and technology.

*3. Bringing into play the government's role and strengthening the state's macrocontrol and management function.* China's enterprise groups have just begun, and the government's role appears particularly important. First, the government must make promotion of the increase of state interests a basic aim and make encouragement and promotion of the development of enterprises the government's basic responsibility. Second, we must strengthen mutual understanding and mutual cooperation between government and enterprise circles, both allowing the government to take the interests of enterprises into adequate consideration and enabling enterprises to adopt a positive attitude in receiving the guidance of the government. The government must discuss with industry the state's development targets and economic priorities, and must be able to mutually and effectively organize exchange. Third, the government must formulate various kinds of economic policies in a timely manner, such as preferential loans, tax reductions and exemptions, development subsidies for new products ordered by the government, fiscal subsidies and other kinds of assistance, up to the formulation of related laws and regulations, making the concept of enterprise groups strict with respect to law and standardizing their structure, and preventing the appearance of converted administrative companies in the guise of enterprise groups, as well as preventing them from receiving undue protection.

*4. Development of enterprise groups should focus primarily on production technology-type enterprise groups, and we must by all means avoid blindly following the foreign model of so-called financial-type enterprise groups.* Japanese enterprise groups can be divided into two broad categories according to their strengths: financial-type and technology-type. The industry of the former has its own specific historical environment and has evolved based on the original zaibatsu, while the latter came to

the fore during Japan's postwar period of rapid economic growth. In view of China's present economic foundation, social environment, and historical conditions, as well as the significance to economic development as a whole, we are more suited to the development of primarily technological-type enterprise groups. This is not only because this type of enterprise group has high operational efficiency and rapid development speed, advanced technology and product mix, and a relatively strong consciousness of the development of new technology and new products, but also because it has a strong consciousness of competition and unique market concepts; this is essential to the currently developing Chinese enterprise groups.

5. *Conversion to the share system is the mature model of the development of China's enterprise groups, and merger between enterprises inevitably appears in this process.* However, this process must conform to economic laws and regulations and to the course of economic development; artificial forcing or administrative interference without regard for objective facts will inevitably get half the result with twice the effort. After the mid-1950's, a trend toward merger into groups also appeared in the United States, and many companies blindly implemented a diversified operation strategy, but because they lacked prior preparation in organization and management, by the first half of the 1970's, many companies which had merged blindly had no choice but to announce dissolution. There is currently a trend toward enterprise merger in China, too, and we must have a sober understanding of this. Unless there is a perfect enterprise form and market mechanism, it is also very difficult to have a sound enterprise merger mechanism. However, it is precisely in this area that China appears weak, and this causes merger behavior to have a congenital deficiency and brings an unfavorable influence on the development of enterprise groups.

6. *In terms of the interior of enterprise groups, the concept of overall interests must be accepted by our entrepreneurs and managers.* Enterprise groups as a whole, in order to seek the benefits of economies of scale, rely on their enormous strength of joint investment, joint development of advertisement and information collection activities, joint implementation of trademark control, and joint consultation on the group's operational strategy and development strategy; their binding point lies in seeking group benefits. However, since China's enterprises have long been in an environment in which there are barriers between higher and lower levels and between different departments and regions, even though development of enterprise groups can break down these barriers, the inherent selfish departmentalistic thinking often cannot be eradicated. Therefore, establishment of the concept of the "group principle" is also a basis for development of enterprise groups.

#### Footnotes

1. *Japanese Monopoly Enterprise Groups*, pp 14, 19, The Commercial Press.

2. Ibid.

3. *The Mystery of Japan's High-Speed Economic Development*, p 24.

## AGRICULTURE

### Fiscal Measures for Agriculture

40060551 Chongqing GAIGE [REFORM] in Chinese  
No 2, 20 Mar 89 pp 140-144

[Article by Huang Xin 7806 9515: "Fiscal Measures To Help Agriculture Emerge From Its Critical Situation"]

#### [Text] I. Raising the Question

The output-related system of contracted responsibility was the first step in rural reform. It was the curtain raiser for China's successful economic reform, and its successes have attracted worldwide attention. However, we have to be aware of the fact that since 1985 Chinese agriculture has experienced a depression. After the rural areas entered the second stage of reform in 1985, a stage centering around the reform of the centralized system of purchases by state quotas, some considerable successes were achieved in the development of town and township enterprises by fostering the rural markets, adjusting the rural industrial structure, and reforming the rural property system. There also appeared, however, a novel phenomenon of upward and downward fluctuations in agricultural prices. For 3 continuous years, during the period from 1985 to 1987, agriculture failed to fulfill its grain plan, and never again attained the production level of 1984. The gap between supply and demand of cotton led to a real "cotton war." Pork production fell to such an extent that many large and medium cities had to return to a ration system. Prices for vegetables rose in a steadily upward, so that people had problems filling their vegetable baskets. All these circumstances held the potential for social instability. Insufficient supplies from agriculture (of course there were also other reasons) led to "silk wars," "cocoon wars," etc., which was a clear indication that agriculture was indeed facing serious difficulties.

Just when the Chinese agricultural plight was at its peak during the second stage of reform, the central authorities came out with new demands on the rural areas. Because "improving the economic environment" during this year and next is dependent on a steady growth of agriculture (which is also expected to establish a new economic order), the situation in agriculture has grown even more critical, and its tasks even more arduous. At this juncture, the need to extricate agriculture from its difficulties has become extremely pressing. In reviewing the factors that caused these agricultural hard times, the most common and emphatically expressed view is that fiscal investments in agriculture have been inadequate. We believe that if this problem is dialectically analyzed we

must not fully blame the production fluctuations, especially grain production, on insufficient fiscal investments; nor castigate the fiscal administration for it, without seeking a more comprehensive regulation of the matter. But we must also not remain blind to the responsibility of the fiscal administration in the matter, consequently ignoring the fact that fiscal policy has to be activated to help agriculture emerge from its difficulties. In view of the present extremely strained financial situation of the state, helping agriculture extricate itself from its difficulties would of course impose appreciable pressure on the treasury. As a short-range measure, an adjustment of the fiscal income-expenditure structure and increasing investments in agriculture and agriculture-supporting industries, could perhaps achieve some quick results. But in the long run, if efforts of state finance would be only directed superficially to income-expenditure manipulations, without taking the initiative in an assault, by means of renovating and readjusting, on concepts, organization, and also by similar action in the field of agricultural distribution relations, public finance would not only not be able to help agriculture ultimately escape from its difficulties, but would increase the burden on itself, the treasury, which could possibly lead to the danger of retrogressing to the old methods of public finance. The main theme of this article will discuss how public finance, while helping agriculture escape from its difficulties and attain stable development, can at this opportune moment also overcome its own difficulties and straighten out the distribution relations between the central authorities and the local authorities and between agriculture and the other sectors of the economy, i.e., how public finance and agriculture by means of "reform, demand, expenditure" and also with "reform, demand, income" can get out of the "two-fold dilemma."

## II. Analyzing the Reasons for the Inherently Related Difficulties in Agriculture and in Public Finance

*A. Reduced state investments in agriculture, one of the reasons for difficulties in agriculture.* International experiences show that the more important the position of agriculture in a national economy, the higher the proportion of funds budgeted by that state for investments in agriculture. In the initial and developmental stages of agriculture, the state must provide large amounts of investment to promote technological progress in agriculture, opening up of resources, building the infrastructure (regulation of streams and rivers), also to promote agricultural education, research, and the spread of technological innovations as well as the utilization and protection of agricultural resources and the environment, i.e. to support agriculture in material respects. Once agriculture attains a certain level of development, and a buyer's market develops in the supply and demand of agricultural products, the state should adopt a protective policy of a compensatory nature, adopt price support measures backed by state finance, and thus dispel the agricultural crisis that might be brought about by surplus production. In brief, investments by public finance are supportive measures that agricultural development cannot do without, and for which there is no substitute.

Examining the present state of China's agriculture, we see that, on the one hand, agriculture still constitutes the foundation of China's national economy. Compared with the ratios of agricultural output value in the GNPs of the United States and Japan during the period from 1970 to 1975, which were 3.3 and 5.7 percent respectively, the ratios for China's agriculture in 1986 and 1987 were 21.05 and 20.26 percent respectively. China's agriculture is still in the stage of development, and the shortage of agricultural products is extremely serious. All this points to the fact that China's national economy relies very heavily on agriculture, and if we additionally consider the great weakness in China's agricultural development, there is indeed the need for large investments by the government to achieve a steady growth in agriculture. On the other hand, development of all other sectors of the national economy, based on the foundation of agriculture, provide the foundation for China's financial accumulations. Detrimental developments in agriculture are bound to adversely affect all other sectors of the economy, and as a consequence will have adverse effects on the state's finances, and these effects will, furthermore, be of a basic and substantial nature. State finance has therefore always attached importance to the support of agricultural development, in consideration of agriculture's strategic position and influence on public finance. According to statistics, funds expanded by the state on agriculture during the period from 1952 to 1985, including allocations for basic agricultural projects, expenditure in support of agricultural production, various expenditures on agricultural undertakings, increased allocations as working capital for agricultural enterprises, and agricultural relief funds, totalled 255.28 billion yuan, which accounted for 10.8 percent of the total fiscal expenditure. This has had a very powerful promotional effect on agricultural development.

However, after the abundant harvest of 1984, due to a warped assessment of the situation in the rural areas, and insufficient investments in agriculture, investments in agriculture declined, in relative figures as well as in absolute amounts. As regards investments in agricultural capital constructions from the state's agriculture support fund, these had started to decline earlier, even before 1984. The ratio of investments in agricultural capital constructions within the total capital construction investments dropped from 11.5 percent during the period from the First to the Fifth 5-Year Plan to 6.5 percent in the Sixth 5-Year Plan. In absolute figures, they declined from 26.8 billion yuan during the Fifth 5-Year Plan to 21.5 billion yuan in the Sixth 5-Year Plan. The reason why agriculture could still register a steady growth during the Sixth 5-Year Plan was, apart from the adoption of the contract responsibility system, only due to the effects of the state's prior long-term investments in agriculture. There is a cause-and-effect relationship between the reduction of the state's investments in agriculture and the large fluctuations in the volume of major agricultural products being produced.

*B. The financial system of "eating from separate kitchens," of which contractual responsibility for taxable profits is the center piece, has delegated considerable financial autonomy to local governments, and although it gave some support to the reform of the urban economic system, it had various disadvantageous effects on agriculture.*

The reform of the urban economic system failed by far to truly achieve the objective of rendering the industrial enterprises independent in the management of their business operations and turning them into legal persons responsible for their own profits and losses. The strata-gem of contractual undertaking of financial obligations enabled the urban industrial enterprises to gain ever increasing benefits which they did not at all earn by their own efforts. Even delegation of all authority and financial power by the central government to local governments could in the end not raise state revenue, but it rather resulted in a serious weakening of the state's powers of macroeconomic regulation and control, leaving it with less and less resources to support agriculture.

The fact that macroeconomic measures of regulation and control were not sufficiently all-embracing and the inducements of the system of contractual responsibility for own finances hindered improving the coordination to the largest extent of resources, capital, and technologies according to the course of right-scale efficiency. The provinces have taken away the investment and quota allocating powers of the central authorities, but instead of investing in agriculture, they concentrated their efforts on the development of overproducing manufacturing industries, where they had regional financial autonomy and which yielded high profits, while, at the same time, strengthening the administrative barriers around themselves. As a consequence, basic water conservancy facilities were weakened, seed quality declined, the area of cultivated land decreased, soil quality deteriorated, and the development of agriculture-supporting industries was slowed down. All this contributed to intensify the dichotomy in the economic structure. In the "war for agricultural products," which was in a special way connected with the system of contractual responsibility for own finances, purchase prices were attuned to market conditions, or, if prices were state-controlled, controls were never strictly enforced due to the prevailing regional separatism. However, grain prices were rigidly fixed, and peasants growing non-grain crops, although sometimes losing money due to the vagaries of the market, could achieve a much higher rate of profits than those who grew grain. This situation dampened all enthusiasm for grain growing, and everywhere peasants grew mulberry or ramie instead.

Because of the disparity in the foreign exchange rates and costs as between products of the manufacturing industry and agricultural products, the foreign trade guarantee system, in contrast to the financial system, caused production, processing, and exports of non-grain crops to become the mainstay and favorite of regional economic developments under the system of contractual

financial responsibility. This contributed even more to the imbalance in the rural industrial structure and directly jeopardized grain production.

*C. Decline of investments by the peasants themselves.* There are also deeper economic reasons for the insufficient investments by peasants. First, the contractual responsibility system was not based on a clear right to independent management, and did not, furthermore, clarify ownership relations, did not clearly define property rights, and did not raise sufficient investment confidence among the peasants. Second, there were no unimpeded channels for the circulation of capital goods. Extortionist imposts that were collected at every level continuously raised costs of capital goods. Add to it that each peasant's limited annual income was subjected to various financial levies, descending on them somewhat like a big storm, so that whatever little would be left to him would not allow him to expand reproduction. Third, the very low incomes in agriculture due to the inordinately low prices for agricultural products and the steadily deteriorating comparative returns from growing grain has induced a portion of the well-off peasants to put their capital into nonagricultural industries, as, for instance, by moving into the cities and starting tertiary industries. Fourth, currency inflation has had not only the effect of inducing peasants to increase their consumption expenditure and reducing accumulations, but also of introducing a very unrealistic element into fiscal revenue. The rigidity of necessary disbursements compelled the treasury to increase expenditure, and the resulting red figures aggravated the currency inflation, which undoubtedly increased the "Engel coefficient" of the peasants, and that in turn led to a reduction of peasant investments.

To sum up the above, agriculture and public finance seem both to have been caught in an interacting chain of difficulties. There is bound to come a day when the continuously increasing amount of subsidies, paid by the treasury when purchasing above-quota agricultural products at higher prices, will be beyond the treasury's capacity to pay. The price subsidies are becoming an increasingly heavier burden for the central government's treasury, and, adding to it the side effects of the contractual financial responsibility system, this situation leaves no financial resources for large-scale investments in agriculture. As a result, the level of agricultural production will decline, and agricultural production, especially grain production, because of its low comparative returns, will further decline in volume. Other production, and even fiscal revenue, will all be adversely affected, while increased investments to protect grain production will further increase the disbursements of the treasury, which in turn will aggravate the difficulties of the treasury. Faced with this double dilemma, the only feasible alternative would be to reform the system of public finance, and, one step further, straighten out the distribution relations between the state and the peasants.



### III. Reforming the System, Straightening Out Relations—Comprehensive Measures To Counter the Difficulties in Agriculture

Above analysis allows the following conclusions: As it affects the economic development of agriculture, the financial system is clearly inadequate. Planning and transforming the financial system must first of all consider the realities of present-day Chinese agriculture; it must neither lag behind nor be undertaken precipitously. Between agricultural development (particularly in its initial stage), and state finance (particularly the finances of the central authorities), there exists a relationship of natural interdependence, which has almost developed into a law governing agricultural development. At its level and efficiency of production, China's agriculture is at the beginning stage and is urgently in need of large-scale support from state finance. The present organizational system of China's public finance is most unsuited to meet the realities of the situation. To render it suitable for the development of agriculture, our reform of the financial system must therefore start with a readjustment of distribution relations at all stages between the central financial authorities and the local financial authorities, between the central financial authorities and agriculture, and between the central financial authorities and the peasants.

The overall strategy of reforming the financial system may be summed up as: weakening of the medium, having fund allocations flow in separate directions, giving priority to agriculture, and proceeding in gradual stages.

*A. Short-Term Plan (1988-1990).* In line with the expectations in agriculture, defined by the Central Committee for this year and next year, as "improving the economic environment and rectifying the economic order," and in order to ensure increased production and a good agricultural harvest, the treasury must apportion some of its financial resources to increased investments in agriculture. To pursue a method that will be satisfactory on both counts, namely guarantee that the central financial authorities will execute an overall plan which will make substantial financial resources available for agriculture as well as for the entire national economy on the one hand, and on the other also avoid regression to the old system of public finance. It will be necessary, not only to use all this expenditure from the amounts amassed at the local level to whatever is under the control of the central authorities, but also to effect reforms of the current contractual financial responsibility system, to improve the all-round contract system, and the contract system computed on base figures, and to institute various forms of contract methods, such as contractual responsibility for progressive income, proportional share of total quotas, proportional share of total quotas with additional share in additional growth, contractual turning over progressively increasing amounts to higher authority, fixed quotas to be turned over to higher authority, fixed quota subsidies, etc. We must also open up certain sound channels for agricultural investments, such as allocating

an appropriate portion of extra-budgetary funds for an agricultural development fund. In the case of foreign capital and loans, we must strive to use them as much as possible for projects of agricultural development and for agriculture-related industrial projects. Whatever financial resources can be accumulated must be used to an appropriate proportion to support agriculture, in particular agriculture-related industries. Of course, these are measures of expediency to meet an emergency. To ensure the long-lasting steady growth of agriculture, it is necessary to go one step further in the reform system of our public finance.

*B. Plan for the Medium Term.* While maintaining an appropriately centralized type of financial system, we must stress the effective regulation of the distribution relation between state and peasants, encourage the peasants to abandon short-range behavior, and increase investments in agriculture. On the basis of the property rights of provincial rank, that had been appropriately accumulated during the short-term plan, and of the finances of the central authorities; furthermore, we must redistribute organizationally the budgetary control rights of the authorities of provincial and prefectural rank among the financial authorities of county (including municipalities and regions of county rank from now on) as well as of township rank, located nearest to the actual agricultural operations. The duration of the medium period should start in 1991 and extend until such time when the major agricultural products, in addition to satisfying all domestic needs, will be available in large quantities for export, and when the share of agriculture in the domestic gross social output value will not exceed 10 percent.

(1) Effective regulation of distribution relations between the state and the peasants. Apart from relying on investments by state finance, the crucial point to ensure stability of agricultural production remains the necessity to dispel peasant misgivings about land ownership and management rights, effective reform of the land system, and beyond that, clarification of the peasants' relation to the land; furthermore, on this basis, straightening out the distribution relation between state and peasants. Opinions are widely divided among theorists as methods of effectively reform the land system. I agree with the proposition that the state has ownership of the land, while it may be occupied and used by individual peasants. That means that the state has the ultimate ownership right of the land, while each piece of arable land is occupied by a specific person. Peasants may occupy and use land for indefinite periods of time; they may inherit, lease, and transfer it. Because the state is the ultimate owner of the land, there are certain restrictions for the peasant who occupies and uses the land. For instance, the peasant may not, of his own authority, transfer or sell arable land to someone who will not use it for agricultural purposes; nor may he sell it to a foreigner, and may not transform arable land into nonagricultural land. This will preserve public ownership of the land and also dispel

doubts peasants may have with regard to land ownership and use rights, so that they will not be inclined to act from merely short-range motivations.

Objective of reforming the present land system is not to initiate scattered operations by single families or households. A characteristic of modern agriculture is to achieve right-scale economy through right-scale efficiency. After clarifying the relationship between land ownership and land user right, it is therefore also necessary to guide agriculture gradually from scattered operations to an appropriate measure of right-scale operations. This is also one item within the distribution relations between state and peasants that state finance must accurately regulate. The form of this guidance must be an orderly and gradual process, skillfully performed as the specific circumstances require, and it is absolutely necessary to avoid undue haste and administratively ordering people about. The state may consider formulating a "Law on Right-Scale Agricultural Operations." This law could clearly define the quantitatively specific nature of right-scale operations in different districts, and may have these criteria applied for evaluations leading to rewards of encouragement for right-scale operations. In addition to effectively regulating the distribution relations with peasants working in scattered operations, state finance must also effectively deal with the distribution relations with right-scale economic agricultural enterprises (i.e., with farms and farm owners).

On the strength of its political power, the state will levy an agricultural tax, arable land use tax, and an agriculture and forestry special products tax from the peasants (or farm owners). With regard to the taxation of agriculture, the guiding ideology had been to ensure a long-term stabilization of the tax burden, and as a result the taxation of peasants has been comparatively light, but the various sundry levies and impositions have been "as many as hairs on an ox." We should, therefore, raise the agricultural tax rates, increase the proportion of the agricultural tax going to the financial organs of counties and townships, or divide the tax revenue completely between counties and townships; and in this way abolish all sundry levies and imposts, thereby widely normalize the distribution relation between public finance and peasants. As the ultimate owner of the land, the state in this status as owner, collects rent from agricultural land. In consideration of the instability of any method based on currency or commodity prices, due to the current irrational price system, land rent should be paid according to the price index of certain commodities. Since the state is owner of all land and other natural resources, the state should simultaneously collect a land-use tax from all users of land throughout the entire society in order to ensure proper use and reclamation of land.

(2) Effective regulation of the distribution relation between central and local authorities. In due consideration of agricultural development and economic reform, the right of budgetary control must be divided in two directions, i.e. it must belong to central financial organs

and also the county-rank financial organs, with the dominant position to be held by the financial organ of the central authorities; this would be most efficient and have the least adverse side effects. In the last few years, the one-sided emphasis on stimulating the enthusiasm of provincial ranking governments and on expanding their autonomy led to "regional separatism," and an intensified "dual economy" structure. In implementing a system of "division in two directions, with predominance of the central authorities," the central finance authorities can regulate the overall distribution of the national income, effect redistribution of benefits for agriculture, and in addition, ensure its own ability of macroeconomic regulation and control, as opportune for the control of nonagricultural developments, for the control of the scope of investments in fixed assets, and for regulating and supporting the improvement of the industrial structure and reform of the urban economic system. County-rank financial authorities, being in the frontline of these affairs, are most familiar with actual conditions and capable of effecting investments in and exercising regulation and control over agriculture under their jurisdiction as best suited to local conditions. In this way they will be able to make up for any deficiencies in macroeconomic investments in agriculture by the central financial authorities, without, on the other hand, engaging in any obvious regional separatism. For this purpose, we have to change the present situation, which actually amounts to having county-rank finance actually "eating public finance," or we may even say "begging food from public finance." We must rather increase the autonomous financial powers of county-rank finance. After instituting the system of "eating from different kitchens," the contract system that many provinces have instituted in their relations with the counties is in fact a disguised form of central control of all income and expenditure. We must, therefore, release county-rank budget control from the budget control by the authorities of provincial rank and sever all their links to provincial or prefectural budgetary income and expenditure. County finance shall be responsible for collecting all local taxes, and for linking all regional social, economic, and cultural developments to local tax revenue in a complete balance of its own of all income and expenditure. The provincial and prefectural budgets shall only be responsible for their own expenditure and a small amount of relevant income, and must not involve themselves any longer with the income of local enterprises.

(3) Reforming management of the agriculture support fund of the central finance authorities. At the present juncture when public finance is in the first stage of supporting agriculture and moving toward development, we must gradually reform the way the agriculture support fund is being managed, in order to have even more capital available to develop nonagricultural industries. In the choice of their agricultural investment projects, the central finance authorities must, therefore, favor those of macroeconomic scope, i.e. projects for which county-rank and township-rank finance is financially not

strong enough to undertake investment such as investment in the regulation of large streams and rivers, development of agricultural industries (fertilizer, plastic film, pesticides, agricultural machinery), and establishment of agricultural bases. As for terms of business operations, some of the projects that are now carried out gratis must be changed to performance against remuneration. In this respect, Japan has provided us with examples to emulate. Apart from a small portion where direct investments were made to start up certain agricultural, forestry, and aquatic undertakings, most Japanese financial investments in agriculture adopted the method of providing subsidies and long-term loans at low interests to peasants. These investments had the effect of using public finance funds to effectively stimulate large amounts of private investments in agriculture. As to the management of the agriculture support fund in its entirety, an overall balance should be maintained, and in each specific project, supervision should follow every step of its execution, firmly insisting on a system of examination and approval of the budget and final accounts of the agriculture support fund. The budget and final accounts of the agriculture support fund must be submitted to the National People's Congress for examination, approval, and enforcement.

(4) Public finance must coordinate its actions with price reform for agricultural products. On the one hand, at times of increased supplies, the interests of the peasants must be protected. On the other hand, on the premise of substantial progress in the reform of the urban enterprise system and reform of the wage system for staff and workers, we must ensure that the consumers of agricultural products bear a part of the financial burden and absorb some of the consequence of rising agricultural prices, so that the price reform will realize the principle of a "trifold share in the burden" of the agricultural price reform.

*C. Long-Range Plan.* At the time when agricultural development, with support from public finance, will have produced a buyer's market, and when industrial

enterprises will have undergone reform and will truly have become economic entities with autonomy in the management of their business operations, responsible for their own profits and losses, a financial system will finally have ended that was characterized by "weakening of the medium, tending toward two sides, with the central authorities in dominant position." It will mean the start of a true system of separate taxation. Comparative research has demonstrated that the system of separate taxation will better suit the realities of the high-speed development of a commodity economy. It is for this reason that I believe that instituting at that time a system of separate taxation, with a separation of authorities as main aspect, would not at all be based on the narrow considerations of a predominantly agriculture-oriented school of thought and a blind discrimination against the development of nonagricultural industries. Instead, it would be based on having agricultural development make "product contributions," "market contributions," and "contributions of key elements," and become the foundation for the development of the commodity economy, and of focusing agricultural development on the development of the planned commodity economy. However, development of agriculture and the reform of the urban industrial structure must both have the backing of a financial system that to some extent will assume a centralized nature. The further we advance in this stage, the less overanxious we must be for the rapid achievement of the ideal system of separate taxation. The critical point is how to shorten this developmental process.

Finally, what has to be pointed out emphatically is that for agriculture to emerge from its difficulties, it is not at all sufficient to merely adopt comprehensive countermeasures in the area of public finance. We must also, as a joint effort, reform the procurement and marketing system as well as the pricing system for agricultural products, reform the system of circulation of rural commodities and the system of capital accommodation, build rural grassroots economic organizations, and establish a system of township enterprises.

**May 4th Movement, Modernization**  
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[Article by Wang Zhangwei 3769 4545 4850]

[Text] What was the May 4th Movement really about? What was its true significance? If we look beneath the surface and consider it overall, it is easy to see: "May 4th" was an earthshaking ideological enlightenment movement. It was really about calling for the modernization of the Chinese people. Its true significance was in bringing about the transformation of Chinese society by reforming man.

We can see from various publications before and after the May 4th Movement that the common understanding of the intellectuals of the time who had been brought into the New Culture Movement—regardless of whether they styled themselves as "new men," "prophets," or "sounders of the alarm," and no matter what "-ism" they sincerely believed in or what method of saving the country they held in esteem—was that "new people" were necessary to save the country; transformation of the people was a prerequisite for transforming society; the Chinese had to "escape the age of barbarism and shame" to make the country develop vigorously. On the surface, "May 4th" was a struggle between new and old culture, and between new and old ideology. Therefore, what this collision of ideology and culture released was the ability of the Chinese people to contemplate, awaken, and move towards modernization. It is in this context that the May 4th Movement should be seen as a movement that urged the Chinese people to modernize in terms of cultural psychology.

#### **Modernization Qualities, Characteristics the Chinese People Ought To Have**

Generally speaking, modernizing people refers to modernizing their nature. They have various qualities, both material and spiritual. The most important among them is the quality of their spiritual culture. Differences between people are mainly seen in the widely varying quality of spiritual culture. Therefore, to modernize a people, one must first set one's sights upon modernizing the quality of spiritual culture. Only by continuous renewal and enrichment in this regard can a people have the ability to understand self autonomy, tame nature, and adapt to social change; only then can a people become free, genuine, and modernized. The initiators of "May 4th" spared no efforts advocating "renewal," "awakening," "moral revolution," and "transformation of both spirit and flesh," indicating their understanding of and strong demand for reforming the quality of man's spiritual culture. The new age and the new tide compelled them to ponder more deeply the modernization qualities and characteristics the Chinese people ought to have, bringing out the following relatively unanimous opinions:

**Individual Initiative** Ch'en Tu-hsiu held that so-called individual initiative meant "each individual has the right to act on his own, one definitely does not have the right to enslave others or the obligation to enslave oneself." People should have "independent individual initiative." Society should recognize and respect the value and dignity of the individual. Therefore, individual initiative is actually democracy. Promoting individual initiative means opposing slavery, dependence, following blindly, dictatorship, autocracy, and the feudal ethics and morals of enslaving others.

**Self-Strengthening** As the intellectuals of "May 4th" saw it, so-called self-strengthening was a kind of "spirit of awareness of dignity." At the same time, they firmly believed that "human happiness depends on one's own efforts. It is not granted by God." They held the lofty sentiments of "that which is under heaven is ours," and "if we don't speak up, who will? If we don't do it, who will?" Promoting the spirit of self-strengthening meant criticizing the "mandate of heaven," opposing "going along with degenerates" and "committing suicide out of pessimism."

**Enterprise** So-called enterprise means daring to take the initiative, to risk one's skin, not being complacent and conservative, being uneasy about present conditions, not "cowering for momentary comfort." The initiators of "May 4th" contended that enterprise was more than "a human vocation"; it was an irrepressible demand of social evolution.

**Participation** Participation meant taking part in government and social life. It is both a demand of society upon the individual as well as the individual's bounden duty and responsibility to society; it is a kind of understanding that modern society must have. Only by participating in government can the people turn "individual politics" into "national politics," and "false republicanism" into "real republicanism." Only then can they destroy the "peaceful life" that is a pool of stagnant water, creating a thriving "active life." Only then can they truly liberate man's spirit.

**Competitiveness** The initiators of "May 4th" understood competitiveness mainly in terms of the theory of evolution. They said: "Survival of the fittest is a general rule of evolution. Extinction is inevitable for whoever cannot adapt to the demands of the surrounding environment and compete appropriately." They felt that competition meant being unwilling to be subjugated, unwilling to accept failure, and unwilling to lag behind. They believed in "seeking peace and tolerate humiliation and war is bad news," and that "the greatest ills of we Chinese" were "resigning ourselves to adversity," "universe does not come first," and "emphasizing on modesty and tolerance."

**Being Open To the Outside** Being open meant turning to the world and the future. To be open is to be global. In the view of "May 4th's" initiators, being open had

become a kind of "global tide." In order for China to seek ways to survive and to become wealthy and strong, it had to eradicate all kinds and forms of closed country attitudes and adopt "global knowledge."

Scientific Intellectuals of "May 4th" had a wide-ranging understanding of the nature of science. As Ch'en Tu-hsiu and others saw it, science was first and foremost a principle of thinking and a conscious attitude of "planting on solid ground in every step," and "subjecting everything to evidence." Science was "the compass for discovering truth," and "the sole and foremost tool for making progress." Only science could wipe out the "foul atmosphere" of learning, resolve the "life style of ignorance and inferiority," and improve the "energy output of people." Only science could make people leave the "age of barbarism ashamed of being a shallow people."

Even though the characteristics of the quality of spiritual culture advanced by the initiators of "May 4th" could not encompass the entire colonial mentality, still, they represented the main direction of values. These characteristics and their explanation reflected a major need in the development of modern Chinese history.

#### **Methods, Ways "May 4th" Promoted People's Modernization**

"May 4th" promoted the man's modernization by strongly developmental and multifaceted ways. In sum, they were as follows:

##### **1. Strove to cultivate a generation of new men via "ethical revolution" and "moral revolution"**

"May 4th's" origin lay in criticizing the old morality. Intellectuals who lived through the 1898 Reform Movement and the Revolution of 1911 profoundly realized that "the rise and fall of any country always depends on the character of the people of the state." China fell into the state of allowing itself to be trampled upon because of the "three cardinal guides of Confucianism," a "major factor in moral government in all things" which firmly imprisoned the thoughts of the Chinese people, turning them into all sorts of slaves. For a time, "New Youth" turned its talents on criticizing China's feudal morality and its core—the three cardinal guides and the five constant virtues of the feudal ethical code. Li Ta-chao, Ch'en Tu-hsiu, Yi Pai-sha, Wu Yu, Lu Hsun, and Hu Shih were famous intellectuals who criticized the old morality, seeking to "smash the shop of Confucianism."

After "May 4th," using his recently learned principles of historical materialism, Li Ta-chao published the famous theses, "Material and Moral Changes" and "An Economic Explanation for the Causes of Modern Ideological Changes in China," incisively explaining the relationship between morality and the economic base. This was

the first scientific explanation of the necessity and rationale for a moral revolution in modern history. It played the role of awakening the deaf for liberating and modernizing the people.

Changes in ethical and moral views are basic to liberating the individual. Under the attack of this wave, the spirit of science and democracy was promoted and the more than 2,000 year old feudal moral base began to falter. A large group of young students were brought into the tide of liberating the individual and the political movement. The women of China, who had been crushed at the lowest level under the millstone of the feudal ethic code, also began to breathe the air of liberation.

##### **2. By freedom of association, "ways to join with the spirit of colleagues, discuss studies, stand up, and improve the world"**

This is an important characteristic of the initial "May 4th" movement. Many young students resolved to sacrifice themselves for transforming society or a new life. Various societies formed freely one after another. No matter the size, almost all had constitutions, aims, and publications. As a result, "May 4th," particularly the years immediately following it, gave rise to an unprecedented ideological surge in a hundred schools of thought crying out contending and opposing viewpoints. These mass organizations, including some particularly famous ones that were rather long-lived, practically crystallized the spirit of the Chinese generation of that time who had far-reaching aspirations and great potential. They discussed ways and means for transforming China and the world, opening a "large-scale free study" with various sciences, "-isms" and social ideologies. In the free democratic air and with an energetic spirit, the mass organizations dared to think, to speak, and do. They strongly nurtured and affected every member. These mass organizations became schools for the youths to learn from each other and temper themselves. As later Chinese history proves, it was in these mass organizations that the materials for the ridgepoles and the beams of China's revolution, reform, and construction came.

##### **. Threw themselves into social practice, daring to "begin with me"**

Although the Revolution of 1911 failed, thereafter the intellectuals and academics of China expressed virulent dissatisfaction towards the government. Several years before the May 4th Movement, the dissatisfaction was still limited to satirize during idle moments and attacks in the print media. But after the scholarly tide of "May 4th," the situation was vastly different. Throwing oneself into social practice and daring to "begin with me" became practically the uniform cry and self-awakening behavior of intellectuals and young students.

Credit for this change should primarily be given to the education of the May 4th patriotic movement. The success of this struggle made intellectuals and young

students believe that the goal of transforming society could only be reached by "direct action" and "a spirit of sacrifice." The former meant throwing oneself into social practice; the latter meant "beginning with me." These two points were later summarized in Ch'en Tushiu's "The Special Spirit of the May 4th Movement."

Nevertheless, young students are always naive. They easily fantasize, try to be different, and seek "shortcuts." These characteristics are seen as classic examples in the large issue of transforming Chinese society. It is easy to see why young students did not directly plunge into factories and villages (although they recognized that this was how it should be) after the tide of "May 4th" receded, but instead went enthusiastically into Chinese-style "new villages"—experimental, work-study, mutual aid groups.

Life is always the best teacher. After a complicated and idealistic youth, they ended up finding ways to unite with workers and peasants in practice. They realized their own value via this route.

#### 4. Joined the world

During the "May 4th" period many mass organizations were brewing and developing plans to go to Europe under work-study programs so as to understand the world and visit the new Russia. Although they could not go to Russia for various reasons, there was a high tide of travel to France under work-study. In Hunan alone, "the winds swelled up to the clouds for a time and in less than two years, nearly 1,000 students went."

Whether considering the later Chinese revolution or the modernization of the Chinese people, joining the outside world was of profound importance.

#### 5. Reformed and popularized education

Reform of education also developed to a new stage after the "May 4th" tide, in line with the ever-increasing popularization of democracy, science, "worker unity," "equality," and "socialism" in the minds of the people. Even more important at that time was striving for equal education for everyone, popularizing education, and "educating the common people." Actually, there were scores of slogans such as "educate the common man," "educate workers," and "popularize education." Many mass organizations cropped up to study and practice "educating the common man." Various kinds of "work-study" groups, "lecture groups" and night schools surged like sprouts after a spring rain. All of this indicates that educational reform had already changed from nothing into something.

To be sure, some saw education as "omnipotent." They saw educational reform as the "first stage" in "setting out to save this depraved society," as "the prerequisite of prerequisites, the basis of bases." Although this was

surely biased, we should not deny the significance of "educating the common man" because some advocated "educating to save the nation."

#### Deep Enlightenment

This article has not studied this cultural and political movement from the viewpoint of man's modernization in order to curry favor with the powerful or to be fashionable. In fact it is because:

##### 1. "May 4th" was actually a critical juncture in China's move from a traditional to a modernized society

First, as "May 4th" flew the flags of democracy and science, it promoted the overall modernization of the Chinese people on the ideological and cultural levels. For us, it was a modernization baptism, bringing us up to a new level, namely, from democracy to socialism.

Second, it prepared considerable talent for the Chinese revolution and modernization.

Third, it let the Chinese people discover Marxism, promoting the establishment of the CPC, thereby ensuring victory for the new democratic revolution. This victory was a prerequisite for China's modernization.

##### 2. "May 4th" was a mirror of China's modernization history all along

We have heard "May 4th" and seen its influence at practically every critical stage of the past 70 years. "The December 9th Movement," "the July 7th Incident," and "the April 5th Incident" go without saying, and didn't the people hear of an "ideological tide" everywhere during the "Great Cultural Revolution" that was contrary to the spirit of "May 4th"? Didn't we experience the Red Guards' devotion to Mao Zedong and his people's rebellion against the Northern Expedition government then? Actually, Mao used "May 4th" forms to incite the destructive Red Guard tide. As for the decade of reform since the 3d Plenary Session of the NPC, many of its basic slogans, such as reform, opening to the outside world, competition, participation, take the risk, development, science, democracy, etc., were no different, in form at least, from those of "May 4th."

The reason "May 4th" has had such a long-term charm is that, first, its spirit, desires, and the ideals it promoted are still very important today. China's nationalities should continue to have the patriotic spirit of "May 4th" youth as we advance toward modernization. It is a shining spiritual treasure. Second, China still has not resolved the issue of its "global status", as put forth by the initiators of "May 4th" in their desire for the "right to food and rest in this corner of the universe."

##### 3. "May 4th" is useful for today's modernization

"May 4th's" most important lesson is in teaching us that we must scientifically understand and highly regard modernizing the people.

As mentioned above, the Chinese people's acceptance of Marxism and promotion of communism are among the major results of "May 4th." Under the guidance of Marxism, the CPC undertook a new democratic revolution, an important change from traditional to modern society. This revolution's victory eradicated the political and economic stumbling blocks to China's modernization, making it possible to turn the country's several hundred years of passive modernization into an active one. Of course, China has not realized this goal in the several decades since the victory of the revolution. The reasons are naturally complex.

Marxism was originally a thesis for liberating the proletariat and the workers that entirely respected "man," "the liberation of man," and "modernization of man." However, as ethnic and class struggles intensified, and under the influence of the Russian October Revolution, early Marxists in China only hurriedly studied "class struggle" and the "dictatorship of the proletariat" before throwing themselves into the whirlpool of fierce class struggle. After the great revolution failed, the CPC was forced into the countryside. Under conditions of long-term, scattered battles, the Communist Party on the one hand used unique methods to train branches of the peasant revolutionary army while on the other hand they themselves were turned into peasants to a certain degree. The Yanan period was a relatively open period for the CPC. Of course, modernizing man was not put on the agenda of the time. At the dawn of New China, Mao Zedong, in "On the Dictatorship of the Proletariat," proposed educating the peasants and the study of economic responsibility by all insiders, showing that he had begun to realize that the founding of a new country meant one had to respect the modernization of the quality of the people. Until the mid-1950s, when he exhorted the Chinese people to start wars worldwide, he still had not forgotten this point. Yet after the "anti-rightist" campaign of 1957 and in line with the spread of class struggle, the human nature of "politicizing" and "revolutionizing" became the dubious way for 800 million Chinese people to stand up. "Liberation of the individual," "humanity," "reason," "competition," "risk-taking" and other slogans were slandered as the monopoly of the capitalist class and revisionists. Moreover, under Lin Biao's advocacy of "personality worship," the Chinese people who had just been freed from the Confucian ethical code became "slaves" of "the great leader." Thus, "man" and the "study of man" practically became theoretically off limits in a Marxist country such as China because of a superficial understanding in the early stage, and dogmatism and understanding of experience later. And so, 30 years after the victory of the revolution, the change from passive to active modernizing still has not taken place.

The 3d Plenary Session of the NPC brought about a change in focus, thereby bringing about such a change.

However, in the course of it we have forgotten "May 4th's" teachings while putting all effort into modernizing. Today, as we soberly review the past decade it is easy to see that all of the major problems China is facing today reflect an overall inferior quality of the Chinese people (including all levels of cadres). Expansion of class struggle over the past three decades has hindered us from taking off economically and fostering modern talents. In the last decade educational mistakes have further intensified the conflict between the quality of the people and economic development, and in particular the growth of a commodity economy. As every advanced country prepares plans to nurture human talent for the next century, what should we in China do? We should have a definite idea about this as we commemorate the 70th anniversary of the May 4th movement.

### Democracy 'Guarantees Stability, Unity'

HK0706015389 Shanghai SHIJIE JINGJI DAobao  
in Chinese 8 May 89 p 13

[Article by Xu Liangying 6079 5328 5391: "Democracy Is the Only Guarantee for Stability and Unity"]

[Text] The May 4th new cultural movement of 70 years ago was an unprecedented ideological emancipation movement against several thousand years of feudal tradition in China. The movement started in 1915. At that time, Yuan Shikai, who wanted to be emperor, instigated a number of old and young feudal diehards to form a so-called "preparatory committee" to influence public opinion toward his conspiracy. Confronted with this adverse historical trend, Chen Duxiu [7115 3747 4423] proposed to save China with "science and human rights" in his introduction to QINGNIAN ZAZHI (later changed to XIN QINGNIAN). In January 1919, he extended the concept of human rights to democracy and science. With the spirit of conquering mountains and rivers, he said, "We now hold that only democracy and science can save China from moral, academic, and ideological darkness. To support democracy and science, we will never back down, even if we are threatened by government suppression, social abuse, or even sacrifice." This militant pledge, considered a poetic masterpiece through the ages, encouraged generations of Chinese youths to go through fire and water to fight for democracy and science.

The creative contribution to the research of world history and a scientific summarization of the history of human civilization since the Renaissance that made possible for the enlightened thinkers of the May 4th Movement to summarize the essence of modern civilization into democracy and science. The historical experience of both the successes and failures of many countries over the past two centuries or so has proved that democracy and science are the most powerful weapon against autocracy, ignorance, and darkness as well as the two pillars for modern human civilization. Historical



facts have proved that democracy and science constitute the internal motivity on which a modern society depends for development and on which a modern country depends for existence.

Here democracy refers to freedom, equality, human rights, and political ideals and practice based on rule by law, while science refers to the sum of scientific knowledge, scientific thinking, scientific method, and scientific spirit, and above all, the scientific spirit of seeking truth, blazing new trails, and sober rationality. If the spirit of democracy and science proposed during the May 4th Movement could be resolutely implemented, China's modernization would have been realized long ago. It is a pity that the thinkers during the May 4th Movement failed to make a systematic and profound study of democracy or to comprehensively introduce and spread the democratic thinking and theory proved effective long ago in the West. It is also regrettable that Chen Duxiu, who was ready to "shed blood and sacrifice his life" for democracy, regarded democracy as "a thing exclusive to the bourgeoisie" and negated it (in September 1920) one year later. This led China's democratic enlightenment movement astray and for many years people lacked the correct understanding of democracy. It was a historic tragedy, and Chen Duxiu eventually became the victim of the tragedy.

The proposal believing that democracy is exclusive to the bourgeoisie, calling it "bourgeois democracy," and claiming that we should establish democracy with eastern or Chinese characteristics cannot withstand scientific analysis. We can clearly see through a careful study of the history of world civilization and an objective comparison of the civilized history and status quo between the East and West that both democracy and science are the outcome of human rationality and the universal embodiment of human nature. As it is generally acknowledged that "man is the most rational animal," rationality should be the essential content of human nature. Human rationality is manifested in the following two aspects: First, man's rational ability to think, which is indicated in science; and second, for the sake of existence and happiness, man has formed common concepts and moral standards of right and wrong for the whole of mankind (at least civilized mankind), which constitute the basic contents of mankind's social collective rationality—namely, the "truth" in "all men accept the same truth," and which transcend nationality and class. The history of the world over the past 2,000 years or so has proved that democracy conforms to mankind's rational demands. Thus it can be seen that there is no national boundary or class nature for democracy. The so-called democracy with eastern characteristics is but a brand of traditional feudal autocracy, which is manifested mainly in privileged ideas, the social estate system, the hereditary system, and rule by man. This is incompatible with democracy. The stress on eastern characteristics is actually a reproduction of the fallacy "Chinese learning for foundation, Western learning for

application" that went bankrupt a century ago. In a word, democracy and science constitute for all countries the most valuable spiritual wealth and foundation..

Although 78 years have elapsed since China overthrew the autocratic monarchy, the course of democracy is still arduous because China, unlike Europe, did not undergo the Renaissance from the 14th to the 16th century and the Enlightenment from the 17th to the 18th century. In striving for democracy, many people with lofty ideals underwent numerous hardships and even sacrificed their lives. Today in China, insightful persons have realized that without democracy, modernization is out of the question. Democracy is the only way for China to extricate itself from its predicament. It is the only reliable guarantee for stability and unity and the foundation for realizing China's reunification. Hence, while commemorating the May 4th Movement, we should review and sum up the arduous course of the Chinese people's struggles for democracy over the past 70 years. We should acquire a reunderstanding of the great historical and immediate significance of the spirit of the May 4th Movement and launch a steady and deepgoing democratic enlightenment movement.

However, before the activities to commemorate the May 4 movement, an antidemocratic tide emerged advocating autocracy. While newspapers published articles on the so-called "new authoritarianism," "rule by elite," "power politics," and "enlightened autocracy" at great length, there were tremendous difficulties in publishing articles which refuted these fallacies and advocated democracy. The clamor for "new authoritarianism" is but a newly decorated cliché from the "preparatory committee" of 76 years ago that is not worth refuting. In the face of the awakened people, the attempt to turn back the wheel of history and bring great suffering to China again will never succeed.

To extensively carry out the enlightenment of democratic thinking, it is necessary to profoundly study and probe into the theory, practice, and history of democracy and conduct ample discussions on all kinds of views so that everyone (at least the majority) can reach a common understanding of the concept of democracy. Because of the deep-rooted, traditional, feudal ideas of several thousand years, democracy has become a forbidden word. Thanks to opening up in recent years, some speculators and those hunting for novelties have brought a few inferior commodities from the dark corners of the free market abroad to serve as their theory of democracy in order to confuse the young people. As a result, democracy became the target of their attack. This distortion and confusion should be clarified.

What actually does democracy mean? In light of the historical experience and lessons of all countries, I think that the concept of democracy should include the following:

First, affirm that everyone is equal and that human rights are inviolable. Citizens are masters of the country and not subordinates of any aristocrats (individuals or oligarch) or docile tools.

Second, establish the principle that "sovereignty belongs to the people," meaning the whole people adopt the principle of "decision by majority" to exercise rule. It goes without saying that a minority of citizens are still protected by the law and that they still enjoy all kinds of citizens' rights.

Third, such a rule can only be established through the free endorsement of the citizens and no violence or other coercive, illegal means should be applied. Thus, the minority can become the majority and vice-versa through regular free competition and election. Everything should be decided by the voters.

Fourth, all government officials and people's representatives who are people's servants should accept people's supervision. The head of government and people's representatives should be elected from among the people and they should be responsible directly to the voters. Those who are incompetent should be removed from office immediately through legal procedures.

The following conditions should be created to realize democracy:

1. Every citizen has the freedom of speech, publication, and press. Every citizen may openly express all kinds of political views and criticize leaders, without fear of prosecution and retaliation. (End the history of punishing people for their speeches and abolish press and publication censorship.)

2. Strictly establish the legal system and abolish all forms of rule by man. (End the history of rule by man and substituting powers for law.)

3. Restrain powers and avoid the emergence of absolute power. (Put an end to any possibility of autocracy.)

4. Strictly forbid the army from interfering in politics. The army should take orders only from the government. (Put an end to any possibility of military coups d'etat and end the history of militarist government.)

These points are the essentials of democracy; not a single one can be dispensed with.

Thus, it can be seen that enlightenment of democratic thinking is essentially an awakening of the concepts of citizenship and democracy, as well as the establishment of human rights and the legal system. This is undoubtedly a long-term, arduous task for China, which is culturally backward and profoundly influenced by feudal ideas, along with a population of 1.1 billion.

**Taiwanese Businessmen Increase Overseas Investment**

40060595 Hong Kong CHING-CHI TAO-PAO  
[ECONOMIC REPORTER] in Chinese  
No 17, 1 May 89 p 33

[Article by Wang Fu 3769 1788: "Taiwanese Businessmen Increase Overseas Investment"]

[Text] Since Taiwan succeeded Hong Kong, labor shortages this have become increasingly serious. These shortages, in addition to the poor investment environment, have caused many Taiwanese and Hong Kong businessmen to seek foreign investment. If China's coastal regions can firmly grasp development of basic infrastructure and can go one step further in improving the difficult investment environment, not only will they be able to continue attracting Hong Kong investment, but they will also have an opportunity to bring in large amounts of Taiwanese investment. An editorial in the South Korean paper HANGUK ILBO said: "As the economic trade relations between the Chinese mainland, Hong Kong, and Taiwan become closer, a 'big Chinese economic circle' is forming. This will be beneficial for implementation of the 'one country, two systems' lateral thinking, and will allow China the possibility of becoming an economically strong country."

**Labor Shortages, Wage Increases**

Labor shortages and wage increases are the biggest problem for Hong Kong and Taiwanese investors. Even though there are already 4 million workers on the Chinese mainland involved in processing and production for Hong Kong plants, according to recent research estimates of working groups convened from Hong Kong's nine main trade associations, Hong Kong is still short 150,000 workers. If the Hong Kong government does not correct its current policy, by 1994 they will be short 400,000 workers. Some Hong Kong authorities have recently made statements requesting permission to bring in labor; however, the current policy of the Hong Kong government is only to continue encouraging Hong Kong businesspeople to move their operations into the mainland, but not to allow the mainland to export labor to Hong Kong. Taiwan's labor shortage is even more acute. According to estimates from Taiwanese newspapers, Taiwan currently has a shortage of 500,000 workers. Textiles, electronics, and household electrical appliances, which have been called backbone industries in Taiwan, typically are short 20-30 percent. When there is a serious labor shortage wages continuously rise, and in the past 2 years the new Taiwan dollar rose 40 percent against the U.S. dollar so that many Taiwanese businesses already feel that the commodity costs of operating a plant in Taiwan are rising, causing them to lose competitive ability in the international market. Many plants have already cut back on equipment investment on the island. A study of 1070 enterprises conducted by Taiwan authorities showed that investment in equipment this year fell 14.4 percent. Taiwan's largest plastic

enterprise group had already decided in early January to stop investment plans for all expansion and new construction on the island, and they re-instituted evaluations of investment projects that were already in progress.

**Investment in Thailand Has Already Exceeded \$800 Million**

As Taiwan's investment climate has deteriorated, many Taiwanese and Hong Kong businesses have taken their capital and means of production overseas in the past few years. According to the office of Thailand's prime minister, in 1988 Taiwanese businesses filed 400 applications to invest in Thailand, investment capital totaled \$2.128 billion, which was an increase of 2.7 times the previous year. For the 308 applications that were approved, the total investment amount was \$842 million. Taiwanese investment in Thailand has already exceeded Japanese and European investment, and has taken first place. According to investigations by Japan's C. Itoh Trading Company, Thailand's raw materials costs are 30 percent cheaper than Taiwan while labor costs are 50 percent cheaper. This is why Taiwanese and Japanese businesses that used to invest in Taiwan are turning to Thailand. There are also many Taiwanese businesses investing in Malaysia. In 1987, 37 Taiwanese investment projects with a total value of only M\$340 million went to Malaysia; but last year the number of investment projects increased to 111, with a total investment value of M\$829 million. Taiwanese businesses last year engaged in investments in Hong Kong in real estate, manufacturing, and service industries, with a total value of HK\$6.7 billion. According to recent reports from Taiwanese authorities, Taiwan currently has \$76 billion in foreign exchange savings, and in this year alone it increased by more than \$2 billion. In recent years Taiwan has stopped restricting foreign exchange exports. Currently Taiwan has a capital shortage, but a plentiful labor supply. This is a good opportunity for the mainland to bring in Taiwanese investment and to continue to bring in Hong Kong investment.

**A Good Opportunity for the Mainland To Bring in Taiwanese Investment**

In the past few years, while relations have been warming up, quite a few Taiwanese businessmen have gone to the mainland to negotiate and invest. According to reports of Hong Kong newspapers, Taiwanese businesses already have more than 130 investment projects in Fujian with a total investment value of more than HK\$900 million. Taiwan's KONG-SHANG SHIH-PAO reports: Taiwanese businesses use Fujian as a hot spot for investment returning to the mainland. One factor is that the Taiwanese and Fujianese speak a common language and customs are basically the same; in addition many Taiwanese believe that in the future, as things develop, there will be direct boat travel between the two ocean shores. The travel time between Fujian's Xiamen and Taiwan's Taichung harbor is the shortest, and transportation costs

would be cheaper than Guangdong or Shanghai. At the same time, Fujian's labor costs are lower than Guangzhou or Shenzhen. Thus, many Taiwanese have been going through Hong Kong and transferring planes to fly to Xiamen, and then going to other locations in Fujian, such as Fuzhou, Quanzhou to do investigations and have discussions. At this moment, in Xiamen's Huli Industrial Zone, there are several tens of Taiwanese enterprises that are preparing plant design. Some of the land in this zone is still undeveloped, but the factory land has already built up. Moreover, land prices have been rising steadily. Because there are so many Taiwanese shoe factories in the Taiwan commercial zone of the Ji Mei zone, it has been called "Taiwanese shoe city." Taiwan's KONG-SHANG SHIH-PAO says: "Taiwanese and Hong Kong businesspeople are different. They really welcome solely-owned plants and managing the enterprise themselves."

Taiwanese businesses have also gone to cities and counties of Guangzhou, and the Zhujiang Delta to discuss investment in plants. Many of these Taiwanese rely on Hong Kong businessmen to bring them in, or they go in together with the Hong Kong businessmen when they return to the mainland to set up plants or to do materials processing. But according to reports from some returning businesspeople, Guangdong has recently suffered

serious energy shortages, and plants that are already in place can only work three days and stop for four days, and at the same time the workers from other provinces who have come to the Zhujiang Delta are experiencing difficulties getting enough grain rations, transportation is inconvenient in some places, and roads are often closed. In some places it is hard to make phone calls and communications with Hong Kong or Taiwan are inconvenient. So, even though many enter negotiations there are few who actually invest and build plants. Experts in Hong Kong who study the economy of Zhujiang Delta feel that last year, when the Zhujiang Delta and Guangdong were implementing coastal zone economic development strategies, they did not first take care of the basic infrastructure in energy, transportation, and communications, and by not paying attention to conditions they wasted large amounts of labor, materials, and money and went blindly about constructing industrial processing zones. Then, after many of the processing zones had been set up there was still a lot of empty land and there were many empty plants. Some spent over 1 million yuan, but the rate of return was very low. If Guangdong does not spend some energy to build a good basic infrastructure and improve the difficult investment climate, they may lose out on the opportunity to bring in Taiwanese investment and to continue to bring in Hong Kong investment.